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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1986

No. _____

LETTERMAN BROTHERS ENERGY
PROGRAM 1980-2, et. al.,

Petitioners,

v.

BANCTEXAS DALLAS, N.A.,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

WILLIAM A. WINEBERG
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Counsel for Petitioners

DATE: January 7, 1987

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QUESTION PRESENTED

In an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, where a jury found that misrepresentations by a defendant not in privity with the defrauded purchasers induced the investment, is the "out-of-pocket" measure of damages, which measures damages as of the date of investment, the sole measure available, or are there circumstances, when the out-of-pocket measure leaves the defrauded purchasers without a remedy, for application of a rescissionary measure of damages?

PARTIES TO THE PROCEEDING

PETITIONERS:

Letterman Brothers Energy Program 1980-2, a California Limited Partnership

Letterman Brothers Energy Program 1980-5, a California Limited Partnership

Letterman Brothers Energy Program 1980-6, a California Limited Partnership

Letterman Brothers Energy Program 1980-10, a California Limited Partnership

Letterman Brothers Energy Program 1981-1, a California Limited Partnership

Letterman Brothers Energy Program 1981-3, a California Limited Partnership

Letterman Brothers Energy Program 1981-5, a California Limited Partnership

Letterman Brothers Energy Program 1981-6, a California Limited Partnership

Letterman Brothers Energy Program 1981-7, a California Limited Partnership

Letterman Brothers Energy Program 1981-8, a California Limited Partnership

Letterman Brothers Energy Program 1981-9, a California Limited Partnership

RESPONDENT:

BancTexas Dallas, N.A., formerly known as National Bank of Commerce of Dallas, Texas, a National Banking Association

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OPINIONS BELOW

The opinion of the Court of Appeals is reported in 799 F.2d 967 (5th Cir. 1986), and appears in Appendix A hereto. The opinion of the District Court for the Northern District of Texas, dated June 19, 1985, denying petitioners' motion for reconsideration of judgment n.o.v., not reported, appears in Appendix B hereto. The opinion of the District Court dated August 6, 1984 granting respondent's motion for judgment n.o.v. and denying a new trial in the alternative, not reported, appears in Appendix C hereto. A transcript of the District Court's ruling of March 29, 1984 granting respondent's motion for directed verdict appears in Appendix D hereto.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on September 12, 1986. Timely petitions for rehearing and rehearing en banc were denied on October 9, 1986 (802 F.2d 455). This petition for certiorari was filed pursuant to Rule 28.2 within 90 days of that date. The Court's jurisdiction is invoked under 28 U.S.C. Section 1254(1).

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(b):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78bb(a):

> The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder. No State law which prohibits or regulates the making or promoting of wagering or gaming contracts, or the operation of "bucket shops" or other similar or related activities, shall invalidate any put, call, straddle, option, privilege, or other security, or apply to any activity which is incidental or related to the offer, purchase, sale, exercise, settlement, or close out of any such instrument, if such instrument is traded pursuant to rules and regulations of a self-regulatory

organization that are filed with the Commission pursuant to Section 78s(b) of this title.

STATEMENT OF THE CASE

Petitioners are eleven California limited partnerships known as Letterman Brothers Energy Programs 1980-2, 1980-5, 1980-6, 1980-10, 1981-1, 1981-3, 1981-5, 1981-6, 1981-7, 1981-8 and 1981-9 ("Programs"). This action was brought against BancTexas Dallas N.A. ("Bank") to recover damages sustained as a result of being induced, through misrepresentations and omissions by the Bank, to enter into investment contracts with an oil and gas driller and operator, Wells-Battelstein Oil & Gas, Inc. ("Wells-Battelstein").

In the spring of 1980, Wells-Battelstein approached Letterman Brothers seeking investment funds. Barry Battelstein, chairman of Wells-Battelstein, referred Bryce Letterman to the Bank as a business and financial reference. Mr. Battelstein told Mr. Letterman that he had instructed the Bank to speak freely and disclose all relevant information.

Mr. Letterman met with Terry Stuart, Wells-Battelstein's loan officer at the Bank. As the jury found, Mr. Stuart specifically misrepresented that Wells-Battelstein was a competent, successful, experienced and financially sound operator and driller, worthy of a $2.5 million credit limit. Mr. Stuart admitted at trial that he did not disclose all relevant information. He also failed to disclose, as the jury found, that Wells-Battelstein was in a negative working capital position, had a negative cash flow, and that the sale of oil and gas leases and drilling operations, not oil production, generated Wells-Battelstein's income. Relying on these and other misrepresentations of the Bank, discussed infra, the Programs were induced to enter into contracts with Wells-Battelstein.

The investment contract entered into by each Program with Wells-Battelstein provides for payments to Wells-Battelstein for (1) the

acquisition of undivided fractional interests in oil and gas leases, (2) the turnkey price for drilling of wells thereon, and (3) estimated completion costs to be charged to the Program. In addition, each contract imposes liabilities upon the Program for operation, administrative and other expenses.

Besides acting as Wells-Battelstein's reference and recommending Wells-Battelstein as a driller and operator, the Bank offered to finance the Programs' obligations to Wells-Battelstein through loans, fully secured by letters of credit contributed by limited partners. The Bank knew that Wells-Battelstein was a successful promoter in the sale of drilling programs and that it was reaping profits from drilling operations, sale of leases and administrative fees. Otherwise, the Bank had no basis to express an opinion as to Wells-Battelstein's success as an operator.

Unknown to the Programs, Wells-Battelstein was operating a pyramid or Ponzi scheme. At the time of the meeting with Mr. Stuart, the Bank was unwilling to extend any additional credit to Wells-Battelstein. The Bank would only loan more money if additional properties were placed "in production" by Wells-Battelstein and subsequently pledged to the Bank. The Bank knew that Wells-Battelstein, in need of working capital, was dependent upon the sale of additional investment contracts in order to increase its borrowing base at the Bank. Attracting unsuspecting investors such as the Programs allowed Wells-Battelstein to drill more properties which, fraudulently appraised, allowed Wells-Battelstein to expand its collateral pool of "proved" producing reserves. This in turn enabled it to borrow additional funds from the Bank for use as working capital to attract more investors.

Wells-Battelstein became the Bank's largest energy customer, and analyses by the Bank show that Wells-Battelstein and the Programs were very profitable customers. One profitability analysis conducted by the Bank in 1981 showed the Bank earning 38.92 percent on the Wells-Battelstein account.

It was initially contemplated by Mr. Letterman, and confirmed by the Bank, that if the Programs were successful, the letter-of-credit loans would be converted to production loans, based upon appraisals of the properties prepared by an engineer acceptable to the Bank. After the first four Programs entered into contracts with Wells-Battelstein, Mr. Letterman notified both Wells-Battelstein and the Bank that he would not enter into additional contracts with Wells-Battelstein unless satisfactory results from the initial Programs were obtained. With its largest borrower strapped for cash, the Bank arranged

production loans for the first two Programs based upon appraisals prepared by the Bank's "independent" petroleum engineer. The appraisals, which later turned out to be grossly overstated, falsely represented that the properties were worth far more than the amounts invested by these Programs.

In reliance upon the apparent success of those Programs, as demonstrated by the production loans, seven additional Programs entered into contracts with Wells-Battelstein. By August 1981, however, it became apparent that revenue from the properties was not sufficient to service the interest, much less make any principal payments, on the production loans. Unknown to the Programs, Wells-Battelstein and the Bank agreed that Wells-Battelstein would defer billing operating expenses to the Programs, thereby concealing the fact that the properties were being operated at a loss. Eventually, the Programs were advised that the

appraisals for the production loans had been grossly overstated, the loans went into default, Mr. Stuart suddenly resigned from the Bank, and the Bank began to assess the limited partners for interest.

Nevertheless, the Bank continued to "sell" other investors on Wells-Battelstein even as late as October 1981, just prior to the time that the Programs sued Wells-Battelstein in Houston. The Bank, upon Mr. Battelstein's written request, recommended Wells-Battelstein to other unsuspecting, potential investors in glowing terms, even though the Bank was aware of the fraudulent appraisals and refused to lend another penny to Wells-Battelstein. After Wells-Battelstein filed bankruptcy in 1982, the Programs filed this action against the Bank in the United States District Court for the Northern District of Texas.

In March 1984, a jury trial was held on the Programs' claims for violation of Rule 10b-5, fraud, negligent misrepresentation and breach of fiduciary duty. On the issue of damages, the district court admitted evidence as to the exact amounts paid by each Program pursuant to its contract with Wells-Battelstein, as well as all other sums expended as a consequence thereof. In addition, the general partner expressed an uncontroverted opinion that the properties developed and operated pursuant to the contracts with Wells-Battelstein were worthless. The opinion is supported by evidence of the dismal operating record of the properties, where revenue was insufficient throughout 1982 and 1983 to cover operating and administrative expenses, even though the price of oil remained fairly constant throughout the entire period up until the time of trial, varying between $29 and $35 per barrel.

The Programs remained liable for administrative expenses of the general partner, well management fees and plugging and abandonment expenses. The trustee in bankruptcy for Wells-Battelstein continued to operate the properties at a net loss to the Programs. In all, the evidence demonstrated that the Programs' interests were worthless and untradable, and that the Programs were locked into contractual liabilities under the operating agreements.

After all parties had rested, the district court granted the Bank's motion for directed verdict with respect to the Programs' claims for violation of Rule 10b-5 and fraud, ruling that under the "out-of-pocket" measure of damages there was no evidence of the value of the properties to be developed pursuant to the investment contracts, as of the date of each contract. (Appendix D.)

The remaining claims of negligent misrepresentation and breach of fiduciary duty were submitted to the jury which returned a separate verdict in favor of each Program on both claims, awarding damages as follows:

Program 1980-2	$1,067,921.00
Program 1980-5	1,564,585.00
Program 1980-6	806,997.00
Program 1980-10	1,195,537.00
Program 1981-1	1,113,575.00
Program 1981-3	1,264,923.00
Program 1981-5	1,325,326.00
Program 1981-6	869,648.00
Program 1981-7	488,116.00
Program 1981-8	936,596.00
Program 1981-9	333,975.50
TOTAL	$10,985,149.50

In answers to special interrogatories, the jury specifically found that the Bank made the following untrue statements to each Program: (1) that Wells-Battelstein was a competent, successful and experienced operator and driller; (2) that Wells-Battelstein was financially sound; and (3) that Wells-Battelstein was worthy of a $2.5 million credit limit. The jury found that the general

partner of each Program actually and justifiably relied upon the above untrue misrepresentations in deciding to enter into oil and gas ventures with Wells-Battelstein and that the Bank failed to exercise reasonable care or competence in communicating the above material misstatements to each Program. The jury also specifically found that the Bank, during transactions with the Programs, failed to disclose the following true, material facts to each Program: (1) that Wells-Battelstein was in a negative working capital position; (2) that Wells-Battelstein had a negative cash flow; and (3) that the sale of oil and gas leases and drilling operations, not oil production, generated Wells-Battelstein's income.

On August 6, 1984, the district court granted the Bank's motion for judgment n.o.v., holding that the measure of damages for negligent misrepresentation is the same as the

measure for violation of Rule 10b-5 and fraud and, accordingly, judgment should be entered in favor of the Bank for the same reason the court directed verdict in favor of the Bank on the Programs' Rule 10b-5 claims. The court also ruled that the Bank owed no fiduciary duty to any Program as a matter of law. At the same time, the court denied a new trial in the alternative. (Appendix C.)

On June 20, 1985, the district court denied the Programs' motion for reconsideration and for new trial and entered final judgment in favor of the Bank on all claims. (Appendix B.) The judgment was affirmed by the Fifth Circuit in an opinion dated September 12, 1986, which held, inter alia, that the Bank is not within the category of parties against whom rescissionary damages may be awarded. (Appendix A-16.) The Programs'

petition for rehearing and suggestion for hearing en banc were denied on October 9, 1986.

REASONS FOR GRANTING THE WRIT

1. BY EFFECTIVELY DENYING PETITIONERS A REMEDY UNDER RULE 10b-5, THE DECISION BELOW DEMONSTRATES THE NEED, ALREADY RECOGNIZED BY THIS COURT, FOR DELINEATION OF THE CIRCUMSTANCES UNDER WHICH THE RESCISSIONARY MEASURE OF DAMAGES MAY BE EMPLOYED IN A PRIVATE ACTION UNDER RULE 10b-5

In Randall v. Loftsgaarden, 478 U.S. ___, 92 L.Ed. 525, 540-41, 106 S.Ct. 3143 (1986), the Court explicitly recognized that the issue of whether and under what circumstances a rescissionary measure of damages is available under Section 10(b) of the Securities Exchange Act of 1934 is an unsettled one. The Act provides only that recovery shall be limited to a plaintiff's "actual damages". Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. §77bb(a). Ordinarily, actual damages are measured by the "out-of-pocket"

measure of damages. Randall v. Loftsgaarden, supra, 92 L.Ed.2d at 540; Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972). Under the out-of-pocket measure, a defrauded purchaser may recover the difference between the price paid for the security and its true value at the time of purchase absent the misrepresentation. Huddleston v. Herman & MacLean, 640 F.2d 534, 555 (5th Cir. 1981), aff'd in part and rev'd in part on other grounds, 459 U.S. 375 (1983).

The Court has repeatedly recognized, however, that securities laws combatting fraud must be construed flexibly to effectuate their remedial purposes. Herman & MacLean v. Huddleston, supra, 459 U.S. at 386-87, and the courts must adjust the remedies so as to grant the necessary relief where federally secured rights are invaded. J.I. Case Co. v. Borak, 377 U.S. 426, 433 (1964). Where dictated by appropriate circumstances, the courts have

applied a rescissionary (also referred to as rescissory, rescissional and Chasins) measure of damages. Indeed, recent decisions evidence a trend toward the use of the rescissionary measure. Thompson, "The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages," 37 Vand.L.Rev. 349, 351 (1984).

In Randall v. Loftsgaarden, supra, the lower court determined that a rescissionary measure of damages was proper, and respondents abandoned their initial challenge to that ruling. Accordingly, the Court specifically declined to decide whether, assuming that a rescissionary recovery may sometimes be proper under Section 10(b), plaintiffs in such cases should invariably be free to elect a rescissionary measure of damages rather than out-of-pocket damages. 92 L.Ed.2d at 544. This case squarely presents the issue.

Where the fraud induces the investment, rather than affects the price paid for the security, the rescissionary measure of damages is appropriate. Chasins v. Smith Barney & Co., Inc., 438 F.2d 1167, 1173 (2d Cir. 1970); Garnatz v. Stifel, Nicolaus & Co., 559 F.2d 1357, 1360 (8th Cir. 1977), cert. den. 435 U.S. 951 (1978). Under the rescissionary measure of damages, the plaintiff's losses are measured by the amount paid for the security less the value of the security at a time subsequent to the transaction (plus consequential damages). Ideally, the security is valued within a reasonable time after the buyer discovers or should have discovered the fraud. 5C Jacobs, Litigation and Practice Under Rule 10b-5 (2d ed.) ¶260.03[c][iv], at 11-48 through 11-49. In theory, once the buyer discovers or should have discovered the fraud, he assumes the market risk of further loss if he elects not to divest himself.

Esplin v. Hirschi, 402 F.2d 94, 104 (10th Cir. 1968), cert. den. 394 U.S. 928 (1969). If the plaintiff sells the security within a reasonable time after discovering the fraud, his damages are equal to the fair value of the consideration paid for the security in the fraudulent transaction (determined as of the date of the transaction) minus the fair value of the consideration he received in the sale (measured at the date of the sale). 5C Jacobs, supra, at 11-55. This reasoning cannot be applied where the security is untradable, Gottlieb v. Sandia American Corp., 304 F.Supp. 980, 989 (E.D.Pa 1969) aff'd in part and rev'd in part on other grounds, 452 F.2d 510 (3rd Cir.), cert. den. 404 U.S. 398 (1971), and it has been suggested that a cutoff at the date of disclosure is unreasonable where the plaintiff would have trouble divesting his holdings. See Note, "The Measure of Damages in Rule 10b-5 Cases

Involving Actively Traded Securities," 26 Stan.L.Rev. 371, 375 n.23 (1974). Thus, under appropriate circumstances, the security has been valued as of the time of trial. Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F.Supp. 112, 129 (S.D.N.Y. 1974), modified 540 F.2d 27 (2d Cir. 1976).

In affirming the judgment of the district court, the Fifth Circuit rejected the application of the rescissionary measure of damages. Under the rescissionary measure, the Programs' damages would be the amount paid by each Program pursuant to its investment contract with Wells-Battelstein, less the value of that contract as of a date subsequent to discovery of Wells-Battelstein's fraud, plus consequential damages. With respect to all but three Programs, the jury awarded the full amounts expended, impliedly finding that the contracts with Wells-Battelstein were of no positive value. While the Programs have argued that

the contracts should be valued as of the time of trial because the securities are untradable and the Programs are locked into contractual liabilities under the investment contracts, the record demonstrates that the contracts were valueless by the time Wells-Battelstein's fraud was discovered. Indeed, the contracts have a negative value in light of the liabilities assumed under the contracts.

Rather than applying the rescissionary measure of damages, the Fifth Circuit held that the out-of-pocket measure must be employed in this case. 779 F.2d at 972-73, Appendix A-15 through A-17. In doing so, the Fifth Circuit has demonstrated in dramatic fashion the need for delineation by this Court of whether and under what circumstances the rescissionary measure of damages may be utilized. Strict application of the out-of-pocket measure to this and many other securities cases effectively leaves the defrauded

purchaser without a remedy. If each investment contract with Wells-Battelstein must be valued as of the date of the contract (i.e., the date the security is purchased), then it must be concluded that each Program received exactly what it paid for: a commitment by Wells-Battelstein to convey an undivided fractional working interest in an oil and gas lease, a commitment to drill that lease, a commitment to complete those wells which Wells-Battelstein, in its discretion, determines to be commercially productive, and a commitment to operate the completed wells. Thus, as of the date each contract is entered into, no damages have been sustained. The only other reasonable conclusion is that a contract with an inexperienced, unsuccessful, financially unsound operator such as Wells-Battelstein is ipso facto worthless on the date made. That argument was also rejected by the Fifth Circuit. 779 F.2d at 973, Appendix

A-19. Thus, strict adherence to the out-of-pocket measure of damages leaves the Programs without a remedy under Rule 10b-5.

The lower courts have applied rescissionary damages in a broad spectrum of cases. As noted in one respected treatise:

> There is authority that buyers can rely on the Chasins measure under all circumstances. The measure clearly can be used even though (1) the plaintiff bought a block so large that it cannot be sold in the market without an underwritten registration statement; (2) no established market exists for the security; (3) no damages could be shown under the out-of-pocket measure; and (4) the fair value of the security is zero during the reasonable time. Besides, the measure may be available when the fraud relates to the value of the security, to the value of the consideration therefor, or to neither, whether the claimant sells before, during, or after the reasonable time or does not sell at all, and, therefore, even if the plaintiff were for some reason disabled from selling.
>
> 5C Jacobs, supra, §260.03[c][iv], at 11-56 through 11-57, footnotes omitted.

The confusion among the lower courts is well documented. See, e.g., Thompson, supra. The need for guidance by the Court on this issue is manifest.

The present case presents an excellent opportunity to address this issue, left unresolved last term by the Court in Randall v. Loftsgaarden, supra, for the following reasons: (1) The out-of-pocket measure of damages effectively leaves the Programs without a remedy, despite the fact that they suffered millions of dollars in losses as a result of the Bank's misrepresentations; (2) As recognized in the decision below (779 F.2d at 973, n.5, Appendix A-20, n.5), the evil was the inducement, not the price; (3) The Programs and the Bank are not in privity, thus precluding the equitable remedy of rescission; (4) The Programs found themselves locked into a scheme to defraud them, Cf. Basch v. Talley Industries, Inc., 53

F.R.D. 9, 13 (S.D.N.Y. 1971); (5) The securities involved, sold as part of a pyramid or Ponzi scheme, were worthless by the time the fraud was discovered or could have been discovered; and (6) The securities were untradable and valued as of the time of trial.

Thus, the increasing importance of this issue, already recognized by the Court as unsettled, justifies the granting of certiorari to review the judgment below.

2. THE DECISION BELOW CONFLICTS WITH DECISIONS OF OTHER CIRCUITS WHERE THE RESCISSIONARY MEASURE OF DAMAGES HAS BEEN APPLIED

The Fifth Circuit's stated reason for rejecting the use of rescissionary damages conflicts with decisions of other Circuits utilizing the rescissionary measure of damages as an alternative to the out-of-pocket measure. The Fifth Circuit's decision expressly reserves the rescissionary measure of damages for cases (1) in which the purchaser and defendant are in privity or (2) in which the defendant owes some fiduciary duty to the purchaser. 799 F.2d at 972, Appendix A-16. The rescissionary measure of damages was intended to provide a defrauded purchaser with a remedy where strict application of the out-of-pocket measure would leave him undamaged. The relationship between the purchaser and the defendant, the Fifth Circuit's test, is irrelevant to the issue of damages.

Rescissionary damages have most often been awarded in cases where a broker, through the use of misrepresentations unrelated to the price of the security, induces the purchaser to invest. In Chasins v. Smith Barney & Co., Inc., supra, the broker failed to disclose that Smith Barney was making a market in the recommended securities. Because the securities were worth what the plaintiff paid for them on the date of purchase, the out-of-pocket measure would have left the plaintiff undamaged. The Second Circuit held that the evil was the inducement, not the price. Accordingly, damages were properly measured by the amount paid for the securities less the amount received upon their subsequent sale. 438 F.2d at 1173.

In Garnatz v. Stifel, Nicolaus & Co., Inc., supra, the purchaser was fraudulently induced to participate in a special bond margin account program. Although he insisted

on avoiding speculation, most of the bonds purchased for him were rated speculative, and losses ensued. The defendant urged that the out-of-pocket measure be employed. The Eighth Circuit rejected that measure, which would deny any recovery at all:

> In the present case, defendants urge strict application of the out-of-pocket rule. They would deny plaintiff any recovery at all, since the value of the bonds equalled their purchase price. But the fact that plaintiff got what he paid for does not mean he did not suffer any legally cognizable injury from defendants' fraud. It merely indicates that the fraud did not relate to the price of the bonds.
>
> * * *
>
> As in Chasins, the gravamen of the present action was not whether Garnatz bought the bonds for a fair price, but that he bought at all. Absent defendants' representations regarding the safety of the program, plaintiff's express disdain for speculation undoubtedly would have precluded his participation; but the fraudulent promise of a low-cost, income-maximizing, and risk-free investment package overcame plaintiff's caution. Under these circumstances, we believe that a rescissory damage measure, similar to that employed by the court in Chasins, is appropriate. See Cobine, Elements of Liability and Actual Damages in Rule 10b-5 Actions,

> 1972 Ill.L.F. 651, 672-73; Comment, The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities, 26 Stan.L.Rev. 371, 374-77 (1974).
>
> 559 F.2d at 1360-61.

In Esplin v. Hirschi, supra, the Tenth Circuit rejected valuation of the securities as of the date of the transaction where to do so would leave the defrauded purchaser undamaged. "It is not until the existence of the fraudulent conduct is known that the true value of the securities as an investment can be ascertained." 402 F.2d at 104.

In order to rationalize its holding with decisions of other Circuits applying the rescissionary measure where securities were purchased upon the recommendation of a broker, the Fifth Circuit stated:

> A broker is within the category of those who owe a special fiduciary duty to one who purchases securities from the broker or upon the broker's advice.
>
> 799 F.2d at 972, Appendix A-16.

Thus, the Fifth Circuit has pronounced that brokers owe a fiduciary duty to all customers to whom recommendations are made. Such a holding is not only incorrect, see, e.g., Avern Trust v. Clarke, 415 F.2d 1238, 1239-40 (7th Cir. 1969), cert. den. 397 U.S. 963 (1970), it is of great importance to the securities industry as a whole.

The Fifth Circuit stated further:

> A bank, unless it is acting as a broker or in a situation closely analogous to that of a broker, is not within the category of parties against whom recissional damages may be awarded.
>
> 799 F.2d at 972, Appendix A-16.

By focusing on "the category of parties", rather than the reasons for applying the rescissionary measure of damages as an alternative to the out-of-pocket measure, the Fifth

Circuit has thus established an ambiguous[1/] and irrational restriction upon the use of rescissionary damages.

No other Circuit requires privity or a fiduciary relationship in order to apply a rescissionary measure of damages. Thus, in

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1/ One can only speculate under what circumstances a bank may be "acting as a broker or in a situation closely analogous to that of a broker". Indeed, in the present case, the Bank did act in a situation analogous to a broker. The Bank knew that Mr. Letterman was considering investing with Wells-Battelstein and was being referred to the Bank as a reference. A glowing recommendation of Wells-Battelstein under those circumstances was tantamount to a recommendation to invest with Wells-Battelstein. While a broker may earn a small commission, the Bank, after inducing the investments with Wells-Battelstein, made fully secured, extraordinarily profitable loans to the Programs. A broker-dealer, by inducing the purchase of securities in which it is making a market, improves its own position. Similarly, the Bank, by inducing the Programs to invest with Wells-Battelstein, benefited itself while simultaneously solving (at least temporarily) the recurring cash flow problems of its largest energy customer, Wells-Battelstein.

Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, supra, an action by defrauded purchasers against the accountants who prepared the audited report and financial statement of the issuer, the court awarded the total amount invested (reduced by sums already recouped from other defendants) less the value of the securities at the time of trial. 378 F.Supp. at 129. The court emphasized that the false financial statement was a crucial factor in plaintiffs' decision to invest. Id. at 128-29. Contrary to the decision of the Fifth Circuit, the purchasers were not precluded from recovery, even though the accountants were neither in privity nor owed the purchasers a fiduciary duty.

Similarly, the court in Harris v. American Investment Company, 523 F.2d 220, 226 (8th Cir. 1975), cert. denied 423 U.S. 1054 (1976), drew no such distinction in approving

the use of a rescissionary measure of damages against several defendants, including an accounting firm.

The Fifth Circuit explicitly recognized that any misrepresentation on the part of the Bank went to the Programs' decision to choose Wells-Battelstein, rather than to the value of anything purchased by the Programs. 799 F.2d at 973, n.5, Appendix A-20, n.5. By nevertheless rejecting the use of rescissionary damages, the decision below conflicts with decisions in other Circuits awarding rescissionary damages where the out-of-pocket measure leaves the purchaser without a remedy and the evil is the inducement, not the price. Contrary to the Fifth Circuit's decision, rescissionary damages are awarded by other Circuits without regard to the nature of the relationship between the purchaser and the defendant, which has no bearing on the issue of damages.

CONCLUSION

The Court has held that liability for fraudulent conduct under Rule 10b-5 extends to "any person" who engages in fraud in connection with a purchase or sale of securities, Herman & MacLean v. Huddleston, supra, 459 U.S. at 386, n.22, and that the courts must construe the securities laws "flexibly to effectuate [their] remedial purposes". Id. at 386-87. The rescissionary measure of damages is an indispensable part of the enforcement scheme under Rule 10b-5, and this case will provide the Court with an opportunity to address this issue for the first time.

For the reasons stated, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

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DATED: January 7, 1987

APPENDIX A

In re LETTERMAN BROTHERS ENERGY SECURITIES LITIGATION.

Donald A. DRAKE, et al., Plaintiffs,

v.

LETTERMAN TRANSACTION SERVICES, ET AL., Defendants.

LETTERMAN BROTHERS ENERGY PROGRAM, et al., Plaintiffs-Appellants,

v.

BANCTEXAS DALLAS, N.A., et al., Defendants-Appellees.

Richard J. STUART, Et al., Plaintiffs,

v.

LETTERMAN BROTHERS ENERGY, et al., Defendants-Third Party Plaintiffs-Appellants,

v.

BANCTEXAS DALLAS, N.A., et al., Third Party Defendants-Appellees.

No. 85-1446.

United States Court of Appeals, Fifth Circuit

Sept. 12, 1986

Appeal from the United States District Court for the Norther District of Texas.

Before GOLDBERG, WILLIAMS and DAVIS, Circuit Judges.

JERRE S. WILLIAMS, Circuit Judge:

Appellants Letterman Brothers Energy Programs ("Energy Programs"), Letterman Brothers (a California partnership), Bryce L. Letterman, Scott M. Letterman, and Letterman Transaction Services, Inc. (a California corporation) suffered substantial financial losses as a result of investments in oil and gas leases that they entered into with Wells-Battelstein Oil & Gas, Inc. Appellants thereafter brought claims against appellee BancTexas and against Walter D. Wells, Jr. and Barry L. Battelstein, the principal stockholders of Wells-Battelstein, a Texas corporation that operated the leases purchased by appellants. The suit was brought under the federal securities laws and under Texas law. Proceedings against Wells and Battelstein,

however, were subsequently stayed after these two defendants petitioned for relief in bankruptcy court.

The district court directed a verdict in favor of BancTexas on the federal securities claim. The remaining issues of negligent misrepresentation and breach of fiduciary duty were then presented to the jury which found in favor of appellants. Upon BancTexas' motion, however, the district court then ordered judgment for BancTexas notwithstanding these verdicts. Appellants now urge us to reverse these rulings.

I.

The Energy Programs comprise eleven California limited partnerships. Letterman Brothers, a general partnership consisting of Bryce L. Letterman and Scott M. Letterman, is the general partner of each of these limited partnerships. The Lettermans attracted various private investors to participate in

the Energy Programs as limited partners. The Lettermans began participating in oil and gas ventures in 1978. They had formed and operated several limited partnerships of this kind before they entered into the transactions at issue in this case.

In the spring of 1980, Bryce Letterman was approached by Wells-Battelstein about investing in certain oil and gas leases located in Kansas and operated by Wells-Battelstein. At that time, Wells-Battelstein was a new entity created through the merger of two companies previously involved in oil and gas ventures. Wells-Battelstein had approached BancTexas about a loan on or about October, 1979. At the time it approached BancTexas, Wells-Battelstein had a net worth of about $2,500,000. BancTexas agreed to establish a $1,000,000 line of credit for Wells-Battelstein and advanced $400,000 to it based upon an appraisal of leases it held.

Wells-Battelstein's credit line was increased by BancTexas to $2,500,000 on or about June, 1980.

After this initial contact, Bryce Letterman apparently became interested in investing in these leases. Soon thereafter he met with Barry Battelstein in Houston. Letterman also visited various Wells-Battelstein facilities over the next day and a half following his meeting with Battelstein. Letterman talked to various Wells-Battelstein suppliers, a geologist, and a banker at Interfirst Houston. Letterman also received a financial statement and a drilling history of Wells-Battelstein.

Letterman then contacted the head of the energy department at a bank in Ohio that had financed previous Letterman projects. This bank, however informed Letterman that Kansas was outside of the geographical area in which it did business. At that point, Wells-

Battelstein referred Letterman to BancTexas and specifically to Terry Stuart, Wells-Battelstein's loan officer there. Bryce Letterman talked to Stuart regarding financing for these ventures and regarding Wells-Battelstein's reputation with BancTexas.

Letterman testified at trial that Stuart had told him that Wells-Battelstein was one of the bank's most successful customers, that it was a creditworthy company of very high integrity, and that the bank thought a great deal of Wells-Battelstein as a customer. Eventually, it was agreed that BancTexas would provide loans to eight of the eleven Energy Programs that would enter into oil and gas ventures with Wells-Battelstein. The other three Energy Programs borrowed the money they needed from Interfirst Bank Houston.

Each of the oil and gas agreements between Energy Programs and Wells-Battelstein provided for payments to be made by Energy

Programs to Wells-Battelstein for the acquisition of certain oil and gas leases, the turnkey price for drilling wells at the sites specified in the leases, and various other estimated costs incurred in starting production on these lease sites. Operating expenses were to be billed to the Energy Programs separately as they were incurred.

These ventures proved to be far less successful than the participants had hoped because oil and gas production turned out to be lower than had been anticipated. As a result, Energy Programs received revenue well below that needed to pay their debts. Consequently, the Energy Programs suffered large financial losses. Some limited partner investors sued various Letterman entities in two separate actions to recover their investments. One of these suits was brought by a group of investors in the United States District Court for the Northern District of

Texas against certain Letterman entities not appellants in this case. The other suit was filed in California federal court against four of the Energy Programs and other Letterman entities.

In January, 1983, appellants together brought suit against BancTexas complaining of violations of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, as well as claims of negligent misrepresentation and breach of fiduciary duty under Texas law.[1/] This action was consolidated with the investors' suit filed in the Northern District of Texas previously. In the meanwhile, the Energy Programs sued in California had brought a third-party action against BancTexas seeking contribution and

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1/ Letterman Brothers had also brought claims for breach of the covenant of good faith and fair dealing and for violation of the California Corporations Code. These claims, however, were dismissed on March 19, 1984, pursuant to a BancTexas motion for summary judgment.

indemnity. This third-party action was subsequently severed from the California suit, transferred to the Northern District of Texas, and consolidated with the present action.

On March 19, 1984, the consolidated actions were brought to trial before a jury. At the close of appellants' evidence, the bank moved for a directed verdict. After all the parties had rested, the district court granted the bank's motion for a directed verdict with respect to the federal securities claims only, finding that the appellants had not met their burden of proof in establishing the value of the oil and gas leases as of the date appellants entered into their contracts.

Appellants' remaining claims, including those of the investors directed against the Letterman entities, were then submitted to the jury. The jury found against the investors, deciding that the Letterman entities had committed no fraud nor negligent misrepre-

sentation in inducing participation in the Energy Programs. The jury, however, returned verdicts in favor of appellants against the bank on both the negligent misrepresentation and breach of fiduciary duty claims. The jury awarded appellants damages in the amount of $10,980,149.50.

Under Fed.R.Civ.P. 50, the bank then moved for judgment notwithstanding the verdict. The district court granted the bank's motion, finding on the negligent misrepresentation claim that the appellants had failed, as they had on the securities claim, to establish damages. On the fiduciary duty claim the court granted the motion j.n.o.v. because bank owed the appellants no fiduciary duty. The district court also conditionally ruled upon the bank's motion for a new trial pursuant to Rule 50(c)(1), finding that no grounds for granting a new trial existed.

On August 20, 1984, the district court entered judgment in favor of the bank on all claims and also on the third-party action transferred from California. On August 30, 1984, appellants moved for reconsideration of entry of judgment notwithstanding the verdict and for a new trial. Appellants also moved to alter or amend the judgment. On June 20, 1985, the district court denied appellants' motions and entered an amended final judgment in favor of the bank and also entered judgment in favor of the Letterman entities against the investors. Appellants filed timely notice of appeal.[2/]

In summary, appellants now urge us to reverse the decision of the district court in favor of BancTexas directing the verdict on the federal law claims and awarding judgment notwithstanding the verdict on the state law

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2/ No appeal was taken by the investors in their action against the Letterman entities.

claims. Additionally, they ask us to reverse the district court's order denying their motion to amend the judgment with regard to their third-party action against the bank for contribution and indemnity.

II.

We review the directed verdict and the judgment notwithstanding the verdict under the standard set out in Boeing Co. v. Shipman, 411 F.2d 365 (5th Cir. 1969) (en banc):

> On motions for directed verdict and for judgment notwithstanding the verdict the Court should consider all of the evidence -- not just that evidence which supports the non-mover's case -- but in the light and with all reasonable inferences most favorable to the party opposed to the motion. If the facts and inferences point so strongly and overwhelming in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper. On the other hand, if there is substantial evidence opposed to the motions, that is, evidence of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied, and the case submitted to the jury. A mere scintilla is insuffi-

> cient to present a question for the jury. The motions for directed verdict and judgment n.o.v. should not be decided by which side has the better of the case, nor should they be granted only when there is a complete absence of probative facts to support a jury verdict.
>
> Id. at 374.

This standard of review on appeal is the same as that used by a trial judge. Springborn v. American Commercial Barge Lines, Inc., 767 F.2d 89, 94 (5th Cir.1985). It is a stringent standard and reflects the general policy that trial judges should rarely take issues away from juries or upset their verdicts. Nonetheless, a judge's decision to grant a directed verdict or a judgment notwithstanding the verdict is not a matter of discretion, but a conclusion of law based upon a finding that there is insufficient evidence to create a fact question for the jury. Lubbock Feedlots, Inc. v. Iowa Beef Processors, Inc., 630 F.2d 250, 269 n. 22

(5th Cir.1980); see also Harwood & Associates, Inc. v. Texas Bank & Trust, 654 F.2d 1073, 1076 (5th Cir. 1981).

A. Federal Securities Claim

The district court directed a verdict in favor of BancTexas on appellants' federal securities claim because it found appellants had failed to establish damages under the proper measure of damages. Appellants now urge us to reverse this judgment on two grounds. First, they insist that the district court used an improper standard by which to evaluate damages, and second, they argue that sufficient evidence existed to establish the damages under either the standard the court used or the standard they urge.

The district court used the out-of-pocket measure of damages set out in Huddleston v. Herman & MacLean, 640 F.2d 534, 555 (5th Cir.1981), aff'd in part and rev'd in part on other grounds, 459 U.S. 375, 103 S.Ct.

683, 74 L.Ed.2d 548 (1983). Under Huddleston, in a Rule 10b-5 action a purchaser of securities may recover against a defendant with whom the purchaser was not in privity or who owed the purchaser no fiduciary duty only the "difference between the price paid and the 'real' value of the security . . . at the time of the initial purchase by the defrauded buyer." Id. at 556.

Appellants argue first that the district court should have adopted a recissional measure of damages under the rule of Chasins v. Smith, Barney & Co., Inc., 438 F.2d 1167, 1173 (2d Cir.1970). Appellants contend that the instant case is distinguishable from Huddleston and is analogous to Chasins in that it does not involve a misrepresentation of price, but rather an inducement to purchase. We find appellants' argument on this point unpersuasive. This case is squarely within the rule of Huddleston. Huddleston indeed

explicitly reserves the Chasins recissional measure of damages for cases in which the purchaser and defendant are in privity or in which the defendant owes some fiduciary duty to the purchaser. Id. at 554, In Chasins, the plaintiff had been lured into purchasing securities on the basis of misrepresentations made by a broker. A broker is within the category of those who owe a special fiduciary duty to one who purchases securities from the broker or upon the broker's advice. See Huddleston, 640 F.2d at 554; see also Garnatz v. Stifel, Nicolaus & Co., Inc., 559 F.2d 1357, 1360 (8th Cir.1977), cert. denied, 435 U.S. 951, 98 S.Ct. 1578, 55 L.Ed.2d 801 (1978).

A bank, unless it is acting as a broker or in a situation closely analogous to that of a broker, is not within the category of parties against whom recissional damages may be awarded. BancTexas' position in this case

is analogous to that of the accountant-defendant in Huddleston who was held responsible only under the out-of-pocket standard. BancTexas did not act either directly or as agent in the selling of the interests to the Energy Program. Nor was BancTexas in the position of a fiduciary with regard to any of the appellants.[3/] To hold BancTexas liable under a recissional standard "would be to place on [it] the burden of any decline in the value of securities between the date of purchase and the date of sale even though only a portion of that decline may have been proximately caused by the defendant's wrong." Huddleston, 640 F.2d at 555.

Appellants argue that even under the Huddleston standard, they have met their burden of proving damages. Specifically, they contend that the value of their interests at the time of purchase was zero, and thus that

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3/ See Part II-C of this opinion, infra.

there [sic] are entitled to recover from the bank all payments made in connection with the oil and gas leases less whatever income may have been produced. Appellants' argument is without merit on this claim as well.

Despite their assertion that they received only a "bundle of rights" in purchasing these leases, appellants in fact acquired tangible assets. Leases that permit the exploration and exploitation of mineral resources are of considerable value. See Phillips Petroleum Co. v. Cowden, 241 F.2d 586, 590 (5th Cir.1957); Wilson v. Texas Co., 237 S.W.2d 649, 650 (Tex.Civ.App.1951). The leases purchased by appellants here are assets of this kind.[4/] Appellants make no allega-

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[4/] We here deny appellants' motion, carried with the case, to take judicial notice of the bankruptcy court's files in David V. Frederking, Trustee for Wells-Battelstein Oil & Gas, Inc. v. Letterman Brothers Energy Program 1980-2, et al., Adversary No. 84-0384-H3. Appellants argue that these files show the present value of their investments to be worthless.

(footnote continued)

tions that BancTexas made any misrepresentation as to the value of the leases, but only as to the competency of Wells-Battelstein to operate them. The equipment purchased by appellants was also tangible property of some value.

Appellants' argument that these interests were, nevertheless, valueless because of the incompetence and inexperience of Wells-Battelstein is unpersuasive. Appellants, who were experienced in these types of ventures, had the option under the operating agreements to remove Wells-Battelstein as operator. Appellants reliance on Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004 (11th Cir.1985), is misplaced. In Woods, the Court held that bonds upon which the issuer had defaulted had a value of zero notwithstanding

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Inasmuch as the measure of damages under the out-of-pocket rule is computed at the time of the transaction, however, the bankruptcy court's file has no relevance.

the fact that "only a portion of the proceeds released were diverted to an improper end." Id. at 1013. Appellants in this case, however, hold tangible assets consisting of oil and gas leases and drilling equipment. These types of assets are readily distinguishable from bonds in that they have an intrinsic value that may be realized upon resale. Bonds, on the other hand, have no inherent value aside from the issuer's financial soundness and commitment. We hold, therefore, that the district court correctly ruled that appellants had not established any damages under the out-of-pocket standard of Huddleston.

Appellants fall back upon the contention that the damages the jury awarded were proper consequential damages.[5/] A plaintiff in a

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5/ Consequential damages might well have been the preferred remedy for appellants to have sought from the outset of this litigation since any misrepresentation BancTexas might have made went not to the

(footnote continued)

Rule 10b-5 action may properly recover consequential damages from a defendant where the plaintiff was induced to invest on the basis of a material misrepresentation or an omission. James v. Meinke, 778 F.2d 200, 206 (5th Cir.1985). The district court in the case before us described the nature and scope of appropriate consequential damages: "[T]he cost of: selling the leases, drilling to deeper layers to increase production or storing oil awaiting a price increase, all in the hope of recouping losses. In essence . . . [consequential damages] would have been the additional expenses incurred by the energy programs as a result of BancTexas' negligence [sic] misrepresentations." We cannot accept appellants' argument that all their payments made in connection with the

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(footnote continued from previous page)
value of the lease and equipment acquired but to the decision to choose Wells-Battelstein as the operator.

leases qualify as consequential damages. As set out above, there was no evidence introduced into the record indicating that the leases appellants received were worth less than what appellants paid.

Appellants could have sought consequential damages for additional expenses that resulted from BancTexas' misrepresentations that led to the hiring of Wells-Battelstein as the lease operator. Of the $7,759,941 in payments to Wells-Battelstein outlined in appellants' Exhibit H, it is possible that some may have justified a claim of consequential damages. If appellants had broken down the figures to their key exhibit to show how much of the claimed damages could properly have been awarded as consequential damages, some portion of their award might have survived BancTexas' motions. By not doing so,

appellants cannot now be heard to argue this issue. See James, 778 F.2d at 207. We therefore affirm the district court's ruling.

Finally, appellants ask that we remand the case for a new trial with regard only to damages if we affirm the district court's ruling. We cannot do so. Appellants are not entitled to relitigate the issue of damages. The authorities appellants cite to support their position are not on point. Sorrels v. Texas Bank & Trust Co. of Jacksonville Texas, 597 F.2d 997 (5th Cir.1979), in which the issue of damages was remanded for a new trial, was decided upon review of a motion for a new trial, not upon review of a motion for directed verdict or for judgment notwithstanding the verdict that we must undertake here.

Davis v. Safeway Stores, Inc., 532 F.2d 489 (5th Cir.1976), was remanded because the evidence in that case was insufficient to

support the full amount of damages awarded. Unlike the instant case, however, there was enough evidence of damages in Davis to support some award albeit a lower one. Finally, in Gleason v. Title Guarantee Co., 300 F.2d 813 (5th Cir. 1962), the issue of damages was remanded because damages had been awarded under an incorrect legal standard, not because of the nonexistence of evidence to support the award. Appellants had adequate opportunity to present sufficient evidence as to damages in this case. They did not do so and thus are bound by the decision.

B. Negligent Misrepresentation Claim

The district court granted BancTexas judgment on appellants' claims of negligent misrepresentation under Texas law[6/] notwithstanding the jury's verdict for appellants. The district court did so for the same reason

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6/ The parties do not dispute the applicability of Texas law to this issue or to the breach of fiduciary duty issue.

that it directed a verdict for BancTexas on the securities claim: appellants' failure to prove out-of-pocket damages.

Texas law permits an action for negligent misrepresentation, as a form of remedial fraud, as defined in the Restatement (Second) of Torts, §552. Great American Mortgage Investors v. Louisville Title Insurance Co., 597 S.W.2d 425, 429 (Tex.Civ.App.1980); Rosenthal v. Blum, 529 S.W.2d 102, 104 (Tex.Civ.App.1975). As in a Rule 10b-5 action, a plaintiff who establishes the elements of an action for negligent misrepresentation may recover out-of-pocket and consequential damages. Restatement (Second) of Torts, §552B(1) comment a. The measure of damages under §552B is the same as that explained in subsection (1) of §549 of the Restatement (Second). The standard set in §549, in turn, is the same as the out-of-pocket measure of Huddleston, the difference

between the price paid and the actual value of what was purchased on the basis of the misrepresentation. As indicated in our prior discussion, appellants failed to establish damages under this standard inasmuch as they proceeded under a theory that their entire investment was worthless.7/

7/ Appellants argue that Sedco International, S.A. v. Cory, 522 F.Supp. 254 (S.D.Iowa 1981), aff'd 683 F.2d 1201 (8th Cir.), cert. denied, 459 U.S. 1017, 103 S.Ct. 379, 74 L.Ed.2d 512 (1982), supports their position that the value of their leases was zero. Sedco concerned a claim by an investor alleging that he had been wrongfully induced by the defendant to join a Middle East oil venture that subsequently failed, resulting in substantial financial losses to the investor. The district court awarded the investor damages as if the value of his interest in the venture was zero.

Appellants' reliance on this case, however, is misplaced. The investor in Sedco did not purchase interests in oil and gas leases as appellants did here. In Sedco, instead, the venture was a contract with the government of Qatar to reenter oil wells owned by the government and restart production. When the government of Qatar decided to terminate the agreement, the venture retained no interests in any of these wells. Unlike

(footnote continued)

Section 552B(1)(b) also permits the recovery of consequential damages incurred as a result of a plaintiff's reliance upon a negligent misrepresentation. As we have pointed out previously in this opinion appellants did not, however, introduce any evidence to prove that any consequential damages were proximately caused by its reliance on BancTexas' misrepresentations. For the reasons indicated in our discussion of appellants' securities claim, we affirm the district court's ruling on this issue as well.

C. Breach of Fiduciary Duty Claim

The district court also entered judgment for BancTexas on the appellants' claim that BancTexas breached a fiduciary duty to appellants notwithstanding the jury's verdict

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(footnote continued from previous page)
appellants' situation here the venture in Sedco truly owned nothing.

to the contrary. We hold that the district court's ruling on this issue as a matter of Texas law was correct.

Under Texas law there is no general fiduciary obligation between a lender and a borrower or between business parties. Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex.1962). A fiduciary relationship may arise in some circumstances, however, when "'moral, social, domestic or purely personal' relationships" are shown to exist between the parties. Id. Similarly, the existence of "a professional and close personal friendship" between the parties may also establish a fiduciary relationship. Trevino v. Sample, 565 S.W.2d 93, 96 (Tex.Civ.App.1978). Subjective reliance or trust alone, however, is insufficient to establish a fiduciary relationship. Thigpen, 363 S.W.2d at 253. Nor are extensive prior dealings by themselves enough. Id. Under

Texas law, appellants dealings with BancTexas cannot be said to have created any fiduciary obligations between the parties.

Appellants, nonetheless, argue that a fiduciary relationship did exist despite the fact that they had had no prior dealings or any prior relationship with BancTexas. They argue that Stuart misrepresented the financial condition of the bank's customer, Wells-Battelstein, in order to generate business for themselves and to help Wells-Battelstein, a major client. To advance this argument appellants rely upon several cases decided outside of Texas. See Richfield Bank and Trust Co. v. Sjogren, 309 Minn. 362, 244 N.W.2d 648 (1976); First National Bank in Lenox v. Brown, 181 N.W.2d 178 (Iowa 1970); Earl Park State Bank v. Lowmon, 92 Ind.App. 25, 161 N.E. 675 (1928) (en banc).

As pointed out by the district court, however, Richfield Bank and First National Bank are not relevant to this case. In First National Bank, a fiduciary duty was established on the basis of the borrower's subjective trust. In Richfield Bank, liability was found based upon another theory of fraud, not a breach of fiduciary duty.

We also agree with the district court's discussion as to the third case, Earl Park State Bank. In that case, a bank was held liable to a borrower for its officer's failure to disclose a known material fact where there had been a long-standing relationship between the bank officer and the borrower, and where the officer had recommended the loan and had negotiated its terms. Under these circumstances, we conclude that a fiduciary relationship would have been found to exist under Texas law.

D. Dismissal of the Third Party Complaint

The district court also granted BancTexas' motion to dismiss the appellants' third party complaint against it severed from the California action and consolidated with this case. The district court did so because of appellants' failure to request that any instructions concerning the third party action be submitted to the jury.

The district court submitted this case to the jury in the form of a series of specific questions on all material factual issues. Fed.R.Civ.P. 49. A party's failure to object to the omission of any issue in these questions is considered a waiver. Molex, Inc. v. Nolen, 759 F.2d 474, 478 (5th Cir.1985).

Appellants argue that in this particular situation their failure to object to the omission of any issues with regard to their third party complaint against BancTexas did not constitute a waiver. The underlying

claims in appellants' third-party action against BancTexas, they argue, were identical to those presented in appellants' original action. Thus, they insist that there was no need to present additional questions to the jury on these issues.

The breach of fiduciary duty claim was dismissed on its merits in appellants' original action against the bank. So additional questions to the jury were irrelevant. The rule 10b-5 and negligent misrepresentation claims, however, were dismissed for a lack of evidence as to damages. Underlying liability on these claims was established. With regard to these issues then additional jury questions on liability under the third party complaint were not required.

Jury questions, nonetheless, were still necessary to determine the extent of indemnity or contribution owed by the bank to

appellants. As appellants requested no questions on these points, they waived their third-party claims against BancTexas on these issues. Contrary to appellants' argument, a finding of liability on the third-party action would not necessarily make BancTexas responsible for all possible damages that appellants might have been ordered to pay the investors in the California suit.

We note briefly that appellants also argue that the district court was not authorized to enter judgment in a separate action, the third party action, on the basis of the special verdict. The contention is without merit. The third-party action was not a separate action, but one consolidated with the original case in Texas in order to sort out liability as completely as possible between these same parties on issues arising out of the same circumstances and transactions. A district court has the authority

to grant judgment upon a third-party complaint made conditional upon the outcome of the original action. See 6 Wright & Miller Federal Practice and Procedure: Civil, §1451.

III.

For the foregoing reasons we affirm the judgment of the district court.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	M.D.L. NO. 560
	§	
LETTERMAN BROTHERS	§	CIVIL ACTIONS
ENERGY PROGRAM	§	NOS.
SECURITIES LITIGATION	§	CA-3-82-1032-D
	§	CA-3-83-0051-C
	§	CA-3-83-1063-H

ORDER

Came on for consideration Plaintiffs Letterman Brothers Energy Programs' Motion to Alter or Amend Judgment and Motion for Reconsideration and New Trial; and Investor Plaintiffs Donald A. Drake, Mark A. Melgard, Calvin G. Malone and Bruce A. Sanderson's, Motion for a New Trial. Having considered the parties' arguments in light of the applicable case law and the evidence presented at trial, the Court is of the opinion that the motions should be denied, except as provided herein.

INVESTOR PLAINTIFFS' MOTION FOR A NEW TRIAL

The Investor Plaintiffs seek a new trial pursuant to Fed. R. Civ. P. 59(a) as to their claims against the Letterman Brothers Transaction Services, Inc., Letterman Brothers, Bryce Letterman and Scott Letterman (the "Letterman Parties") and their claims against BancTEXAS Dallas, N.A. ("BancTEXAS").

Investor Plaintiffs assert that the jury findings with respect to question no. 8 (pertaining to their negligent misrepresentation claim) and to question no. 18[1/] (pertaining to their federal and state

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1/ Questions nos. 8 and 18 and the jury's answers read as follows:

Question No. 8

Do you find from a preponderance of the evidence that the Letterman Parties made untrue statements which were material in the private placement memorandum regarding the following matters to the Individual Investors?

Answer by placing a check mark (X) under "We do" or "We do not" as to each of the following.

securities claims) regarding the Letterman Parties are totally unsupported by the evidence or, in the alternative, are against the great weight and preponderance of the evidence. The Letterman Parties have not filed a response to this motion.

The Investor Plaintiffs assert that Bryce Letterman testified that he had a full financial statement for Wells-Battelstein Oil & Gas, Inc., (Wells-Battelstein) dated February 29, 1980, setting forth its negative

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ANSWER:

		We do	We do not
(a)	Wells-Battelstein's financial condition:	_____	X
(b)	Wells-Battelstein's obligation to pay drilling and completion costs:	_____	X
(c)	The prior activities of Wells-Battelstein and the Energy Programs:	_____	X

cash flow and working capital, as well as the fact that no more than ten percent of its income was derived from the sale of oil and gas drilling deals and administrative fee income, prior to issuing the offering memoranda for Energy Programs 1980-5, 1981-5,

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Question No. 18

Do you find from a preponderance of the evidence that the Letterman Parties failed to disclose the following statement during the transactions with the Individual Investors and that such statement was true and material?

Answer by placing a check mark (X) under "We do" or "We do not."

ANSWER:

	We do	We do not
Barry Battelstein's personal bankruptcy	_____	X

and 1981-1. Furthermore, they assert that there is evidence that Bryce Letterman was aware of the fact that Barry Battelstein had been through a personal bankruptcy prior to issuing these offerings. Finally, they assert that this information was not disclosed in the offering memoranda and that such information was a material factor in the determination of the Investor Plaintiffs to invest in the three Programs. Whether the jury's answers exonerating the Letterman Parties are supported by the evidence or not, [2/] however,

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2/ Despite the Investor Plaintiffs' contention that the evidence was insufficient to support the jury's answers to questions nos. 8 and 18, the Court is of the opinion that the evidence does support the findings. The Investor Plaintiffs further argue that this Court erroneously dismissed their claims against BancTEXAS based on the jury's findings that the bank did not make negligent misrepresentations nor breach a fiduciary duty, while the jury found in favor of the Energy Programs on the same two theories against BancTEXAS. The Court finds no inconsistency because the issues submitted to the jury on behalf of the Energy Programs and the Investor Plaintiffs were not identical.

is immaterial in light of the fact that the Investor Plaintiffs, like the Energy Programs, failed to establish their damages at trial. See infra. Accordingly, Investor Plaintiffs' Motion for a New Trial as it relates to the Letterman Defendants should be denied.

As grounds for a new trial against BancTEXAS, [3/] the Investor Plaintiffs assert on their claims for negligent misrepresentation and breach of fiduciary duty that the Court's decision to enter judgment against them was erroneous. As the Court more fully explained in its Order of August 6, 1984, there was insufficient evidence presented at trial to support a finding under Texas law of a fiduciary relationship between BancTEXAS and the Energy Programs. There was no additional evidence presented at trial,

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3/ The Investor Plaintiffs failed to address their request for a new trial as it relates to BancTEXAS in their memorandum in support.

beyond that relating to the relationship between BancTEXAS and the Energy Programs, to support a finding of a fiduciary relationship between the Individual Investors and BancTEXAS. Accordingly, there is insufficient evidence to support a jury finding of a fiduciary relationship between BancTEXAS and the Investor Plaintiffs.

The Investor Plaintiffs further assert that they fully established their damages at trial. In support of this assertion, they state that they established their damages by showing the amount of their investment and their return on their investment up to the time of trial. As the Court stated in its Order of August 6, 1984, the appropriate measure of damages was the out-of-pocket loss. This loss reflects the difference between the price paid and the fair market value of the security absent the misrepresentations at the time of the initial purchase by the defrauded buyer. Huddleston v. Herman & McLeah, 640

F.2d 534, 555-56 (5th Cir. 1981), aff'd in part and rev'd in part on other grounds, 459 U.S. 375 (1983). There was insufficient evidence presented at trial to calculate the out-of-pocket loss incurred by the Investor Plaintiffs, as the return on the investment does not reflect the fair market value of the security at the time of purchase.

As there are no grounds put forth by the Investor Plaintiffs for granting a new trial against BancTEXAS, and the Court discerns no such grounds, their motion should be denied as to their claims against BancTEXAS. See Fed. R. Civ. P. 59(a).

ENERGY PROGRAMS' MOTION TO ALTER OR AMEND JUDGMENT

The Energy Programs[4/] seek to have the language on page 2, lines 10 through 13,

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4/ Letterman Brothers Energy Programs 1980-2, 1980-5, 1980-6, 1980-10, 1981-1, 1981-3, 1981-5 [sic], 1981-6, 1981-7, 1981-8, and 1981-9.

"including their third-party action in Cause No. CA-3-83-1063 H" deleted from the Final Judgment Order entered August 20, 1984. They also seek to include an express determination, pursuant to Fed. R. Civ. P. 54(b), that there is no just reason for delay with respect to entry of final judgment.

The third party action in question arises from the case of Stuart, et al. v. Letterman Brothers Energy Programs 1980-2, et al., Cause No. C82-3700-EFL, filed in the United States District Court for the Northern District of California. The Energy Programs filed a third party complaint against BancTEXAS in this action. The third party action was severed from the California action and was transferred by the Judicial Panel on Multidistrict Litigation to this Court on June 13, 1983, and docketed as Letterman Brothers Energy Programs, et al v. BancTEXAS

Dallas, N.A., Cause No. CA-3-83-1063-H.[5/] The Court by Order dated December 12, 1983, consolidated the third party action for pretrial proceedings and for trial under Cause No. CA-3-82-1032-D.[6/] The consolidation was ordered in light of the common questions of law and fact presented in the three cases. See Fed. R. Civ. P. 41(a).

The Court finds that the third party action was in fact tried to the jury. Any failure to submit claims in that action to the

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5/ The main action in the California suit was also transferred by the Judicial Panel on Multidistrict Litigation to this Court on November 25, 1983, and filed under Cause No. CA-3-83-2098-D. Subsequently, on March 27, 1984, the Judicial Panel on Multilitigation entered an order remanding No. CA-3-83-2098 (N.D. Cal. No. C 82-3700 EFL) to the United States District Court for the Northern District of California.

6/ The other actions affected by this order were Drake v. Letterman Transaction Services, Cause No. CA-3-82-1032-D; and Letterman Brothers Energy Programs v. BancTEXAS, Cause No. CA-3-83-0051-C.

jury for consideration is a result of the Energy Programs' failure to request their submission. All of the facts underlying the claims asserted in the California third party action between Energy Programs and BancTEXAS were or could have been presented during the trial before this Court. The claims based upon those facts could have been presented to the jury under an appropriate California, Texas or federal legal standard. Accordingly, the claims asserted in the California third party action are deemed to have been found in accordance with the judgment absolving BancTEXAS of liability to the Energy Programs. See Fed. R. Civ. P. 49(a).

The Energy Programs seek modification under Rule 54(b) under the belief that untried claims remain before this Court. As stated above, the third party claims were tried before the jury. As for any claims against parties in bankruptcy, the Court finds that the assertion of those claims in bankruptcy

proceedings are not prejudiced by a final judgment in this case. As to any claims against parties in bankruptcy that are now pending, the Court is of the opinion that they should be dismissed without prejudice in order that they may be asserted in the bankruptcy proceedings involving those parties. The Final Judgment of the Court should be amended to delete the language denying all relief not specifically granted therein, and to reflect the dismissal of these claims.[7/] Accordingly,

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7/

In the Investor Plaintiffs' suit (No. 82-1032-D), by an amended complaint Wells-Battelstein was added as a party defendant. The defendant Letterman Parties then filed a cross-claim against Wells-Battelstein. Wells-Battelstein thereafter instituted bankruptcy proceedings. By another amended complaint, the Investor Plaintiffs dropped Wells-Battelstein as a defendant; however, the Letterman Parties' cross-claim has not been dismissed.

In the Energy Programs' suit (No. 3-83-0051), Walter D. Wells, Jr., and Barry L. Battelstein were named as original defendants. Thereafter on March 17, 1983, they each filed a bankruptcy proceeding and the Court was apprised of this fact.

The proceedings against the parties in

The Energy Programs' Motion to Alter or Amend Judgment should be denied in all matters except as set out above.

ENERGY PROGRAMS' MOTION FOR RECONSIDERATION AND FOR A NEW TRIAL

The Energy Programs seek to have the Court reconsider its Order of August 6, 1984, granting BancTEXAS' motion for judgment notwithstanding the verdict with regard to the Energy Programs' claims for negligent misrepresentation and breach of fiduciary duty, and in the alternative, have moved for a new trial on their claims of negligent misrepresentation and breach of fiduciary duty and their claims under the Securities and Exchange [sic] of 1934 and for common law fraud.

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bankruptcy were effectively stayed following the filing of the respective bankruptcy proceedings. 11 U.S.C. §362. The claims against the bankrupt parties were not formerly dismissed or severed. It should be noted, however, that the claims against the bankrupts were not included in the pretrial order filed by the parties in this case.

The Energy Programs argue that a continuing relationship existed between BancTEXAS and Letterman Parties such that a fiduciary duty arose with respect to the later Energy Programs. As the Court previously stated in its August 6th Order: "Extensive prior dealings alone will not be sufficient to establish a fiduciary relationship. The Energy Programs must have also established facts, other than subjective trust on their part, showing that the relationship was more than just a debtor-creditor relationship," citing Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962). The evidence presented by the Energy Programs at trial was insufficient to remove their dealings from the sphere of an arms length debtor-creditor relationship. Accordingly, the Court denies the Energy Programs Motion for Reconsideration on the issue of fiduciary duty.

The Energy Programs next urge the Court to adopt the measure of damages utilized by the Second Circuit in its decision in Chasins v. Smith, Barney & Co., 438 F.2d 1167, 1173 (2nd Cir. 1970). Under the Chasins measure of damages a buyer recovers the fair value of the consideration paid less the fair value of the security within a reasonable time after the buyer discovered or should have discovered the fraud. Whether the Chasins or Huddleston, supra, formulation of damages is utilized, the Energy Programs have failed to provide sufficient evidence of the fair market values of the securities on any relevant date. The Energy Programs argue that the value of the contracts is zero, or a negative value, because of the incompetence, inexperience and financial condition of Wells-Battelstein. They point to figures placed in evidence that show a gross profit in some cases, but a net loss in all cases. However, the Energy Programs ignore evidence that was presented at

trial showing, inter alia, that the decrease in the price of oil played a major role in the profitable nature of the oil wells that were drilled. Further, there was evidence that the trustee in bankruptcy of Wells-Battelstein has continued to operate these properties and receive income from oil production, and that the properties do have some value, the exact amount of which was never established.

The Energy Programs have alternatively requested that the Court grant a new trial in order to enable them to provide evidence of damages. The Court does not find that this is sufficient grounds for granting a new trial in this case, in light of the adequate opportunity the Energy Programs had at trial to present evidence on the proper measure of damages. The Energy Programs' failure to present evidence on the proper measure of damages resulted, not from a technical error, but from a conscious decision to pursue a particular theory to measure damages. The

decision was the Energy Programs alone, not contributed to in any way by BancTEXAS. Accordingly, the Energy Programs' motion for a new trial and for reconsideration of judgment n.o.v. is hereby denied.

It is so ORDERED.

Dated this 19 day of June, 1985.

/s/ Robert M. Hill
United States Circuit Judge
Sitting by Designation

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE	§	M.D.L. NO. 560
	§	
LETTERMAN BROTHERS	§	CA-3-82-1032-D
ENERGY PROGRAM	§	CA-3-83-0051-D
SECURITIES LITIGATION	§	CA-3-83-2098-D
	§	

ORDER

Came on for consideration before the Court the motion of BancTexas Dallas, N.A. (BancTexas) for judgment notwithstanding the verdict. BancTexas seeks to have the jury verdict in favor of the Energy Programs,[1] on their claims for negligent misrepresentation and breach of fiduciary duty, set aside pursuant to Fed. R. Civ. P. 50(b). Having considered the parties' arguments, in light of the applicable case law and the evidence

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1. Letterman Brothers Energy Programs 1980-2, 1980-5, 1980-6, 1980-10, 1981-1, 1981-3, 1981-5, 1981-6, 1981-7, 1981-8, and 1981-9.

presented at trial, the court is of the opinion that BancTexas' motion should be granted.

Standard of Review

The standard against which the evidence at trial must be weighed is as follows:

> On motions . . . for judgment notwithstanding the verdict the Court should consider all of the evidence - not just that evidence which supports the non-mover's case - but in the light and with all reasonable inferences most favorable to the party opposed to the motion. If the facts and inferences point so strongly and overwhelmingly in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper. On the other hand, if there is substantial evidence opposed to the weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied and the case submitted to the jury. A mere scintilla of evidence is insufficient to present a question for the jury. The motions for . . . judgment n.o.v. should not be decided by which side has the better case, nor should they be granted only when there is a complete absence of probative facts to support a jury verdict.

> There must be a conflict in substantial evidence to create a jury question. However, it is the function of the jury as the traditional finder of facts, and not the Court, to weigh conflicting evidence and inferences, and determine the credibility of witnesses.

Boeing v. Shipman, 411 F.2d 365, 374-75 (5th Cir. 1969)(en banc), as cited in Intern. Theraputics, Inc. v. McGraw-Edison, Co., 721 F.2d 488, 491 (5th Cir. 1983).

Measure of Damages for Negligent Misrepresentation

At the conclusion of the presentation of evidence the Court directed a verdict in favor of BancTexas on the Energy Programs' causes of action for common law fraud and securities law violations. The Court held that, as a matter of law, the Energy Programs failed to prove the "out-of-pocket" measure of damages. The question of negligent misrepresentation by BancTexas was presented to the jury.[2]

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2. In part II(A) of the jury charge, the Court instructed the jury as follows:

> The damages recoverable for

BancTexas asserts that the measure of damages for negligent misrepresentation, as stated in the Restatement (Second) of Torts §552(B)(1)(a)(1977), is the same as that for common law fraud as stated in §549, the out-of-pocket measure.[3] The Energy Programs respond by arguing that the measures of damage for fraud and negligent misrepresentation

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> negligent misrepresentation are those necessary to compensate for the pecuniary loss of which the misrepresentation is a legal cause, including (a) the difference between the value of what was received in the transaction and its purchase price or other value given for it; and (b) pecuniary loss suffered otherwise as a consequence of the reliance upon the misrepresentation. The damages recoverable do not include the benefit of the relying parties' contract with the party making the negligent misrepresentation.

3. The out-of-pocket measure of damages reflects the difference between the price paid and the fair market value of the security absent the misrepresentations, at the time of the initial purchase by the defrauded buyer. Huddleston v. Herman & MacLeah [sic], 640 F.2d 534, 555-556 (5th Cir. 1981), aff'd in part and rev'd in part on other grounds, 459 U.S. 375 (1983).

differ, and that the damages awarded by the jury were merely consequential damages, awardable under subpart b of §552B(1). These consequential damages allegedly include the expense of each Energy Program in preparing the oil and gas leases for production (i.e. drilling costs, equipment purchases, interest payments on loans). See Restatement (Second) of Torts §549, comment d (1977), as referred to in §552B, comment a. This analysis of subpart (b) will, according to BancTexas, undermine the out-of-pocket rule.

The measure of damages recoverable for fraudulent misrepresentation and for negligent misrepresentation are the same. A review of the relevant sections in the Restatement defining both reveals that the language is identical.[4] Compare §549(1)(a) and (b) with §552B (1)(a) and (b). According to the

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4. It is the second part of the sections, relating to "benefit of the bargain" damages, which differ; those damages being recoverable in the case of fraudulent misrepresentation.

comments accompanying §552B: "[t]he rule stated in this Section applies, as the measure of damages for negligent misrepresentation, the rule of out-of-pocket loss that is stated as to fraudulent misrepresentation in Subsection (1) of §549." §552B, comment a. Furthermore, the reader is directed to comments (a) through (f) under §549 by §552B (1) for guidance. See §552B, comment a. Accordingly, the Court's previous ruling, concluding that the Energy Programs failed as a matter of law to establish out-of-pocket losses, applied to the Energy Programs' claim for damages for negligent misrepresentation.

Subpart b of §552B permits a defrauded purchaser to recover any "pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the misrepresentation." These are consequential damages. See §549, comment d, as referred to in, §552B, comment a. The Energy Programs rely upon the language in comment d of §549, which provides

that consequential damages "may be the expense to which he has gone in preparation for a use of the article for which it would have been appropriate if the representation had been true." Based on this they seek to recover all of the expenses incurred in operating the wells. Such recovery does not comport with the concept of consequential damages.

By definition, recovery may only be gotten for expenses incurred as a consequence of the defendant's actionable conduct. 17 Tex. Jur.2d Damages §15 (1960). The award of all expenses on this case would be improper because the Energy Programs received some value for their expenditure, as evidenced by the returns on their investments. In this case examples of appropriate consequential damages might have been the cost of: selling the leases, drilling to deeper layers to increase production or storing oil awaiting a price increase, all in the hope of recouping losses. In essence it would have been the

additional expenses incurred by the Energy Programs as a result of BancTexas' negligent misrepresentations. Estate Counseling Service v. Merrill Lynch, Pierce, etc., 303 F.2d 527, 533 (10th Cir. 1962). There was insufficient evidence in the record to enable the jury to calculate those additional expenses.

Finally, if one views the jury award as one for recissional damages, as suggested by BancTexas, the result is the same. As previously stated the appropriate measure of damages should have been out-of-pocket, of which there was no evidence.

Breach of Fiduciary Duty

It is BancTexas' position that, as a matter of law, there is no fiduciary relationship between a borrower and a lender. Texas case law does not completely support this conclusion. Rather, there is no general fiduciary obligation between a lender and a borrower under Texas law. See Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962);

Thomson v. Norton, 604 S.W.2d 473, 476 (Tex. Civ. App. - Dallas 1980 - no writ); Winston v. Lake Jackson Bank, 574 S.W.2d 628, 629 (Tex. Civ. App. - Houston [14th Dist.] 1978, no writ); Trevino v. Sample, 565 S.W.2d 93, 96-97 (Tex. Civ. App. - El Paso 1978, writ ref'd n.r.e.).

Under Texas law an arms length transaction may be turned into a fiduciary relationship. The existence of a professional and close personal friendship between Terry Stuart, as a representative of BancTexas, and Bryce Letterman, acting on behalf of the Energy Programs, could give rise to a fiduciary duty. See Trevino, 565 S.W.2d at 96, citing Kalb v. Norsworthy, 428 S.W.2d 701 (Tex. Civ. App. - Houston [1st Dist.] 1968, no writ). Alternatively, "the evidence must show that dealings between the parties have continued for such a period of time that one party is justified in relying on the other party to act in his best interest." Thomason,

604 S.W. 2d at 476, citing Consolidated Gas & Equipment Co. v. Thompson, 405 S.W.2d 333, 334-35 (Tex. 1966). Extensive prior dealings alone, will not be sufficient to establish a fiduciary relationship. The Energy Programs must have also established facts, other than subjective trust on their part, showing that the relationship was more than just a debtor-creditor relationship. Thigpen, 363 S.W.2d at 253; Winston, 574 S.W. 2d at 629. As the court in Thigpen pointed out "[b]usinessmen generally do trust one another, and their dealings are frequently characterized by cordiality . . . ." 574 S.W.2d at 629.

The Energy Programs argue that the "triangular, one-lender two-borrowers relationship" created a fiduciary relationship. To summarize, the Energy Programs assert that the evidence proved that Terry Stuart misrepresented the financial condition of Wells-Battelstein to Bryce Letterman in order to generate business for BancTexas and

to help its largest oil and gas customer, Wells-Battelstein, improve its financial standing with the bank. They rely upon three non-Texas cases in arguing that when there is one lender and two borrowers there is a special duty to disclose even where there has been no prior dealings between the borrower and defendant bank. See Richfield Bank and Trust Co. v. Sjogren, 244 N.W.2d 648 (Minn. 1976); First National Bank in Lenox v. Brown, 181 N.W.2d 178 (Iowa 1970).

The Court does not find these decisions persuasive in light of the clearly enunciated standards set forth in the Texas case law. In First National the Iowa Supreme court relied upon the subjective trust the borrower placed in the bank president in finding that a duty to disclose existed. 181 N.W.2d at 182. Under Thigpen and its progeny the evidence in First National would be insufficient to give rise to a fiduciary relationship. In

Richfield Bank, the Court did not find a fiduciary relationship, rather it relied upon an alternate common law theory of fraud.

The only relevant decision relied upon by Energy Programs is Earl Park State Bank v. Lowmon, 161 N.E. 675 (Ind. App. 1928)(en banc). In Earl Park a bank officer loaned a customer's deposits to another customer with knowledge of the debtor's insolvency.[5] The court held that recovery would be appropriate if the lender had relied upon the bank and its officer, and the officer had acted in bad faith, suppressing the truth. 161 N.E. at 679. It is important to note that the bank and its officer recommended the loan and negotiated the terms of the loan. Id. It was also alleged in this action that the lender had been acquainted with the bank officer for

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5. The relevant section of the opinion relates to a ratification defense asserted by the Bank; the language, however, includes a breach of fiduciary duty claim. See 161 N.E. at 679.

many years. The Indiana court's concern about all of these factors: lengthy prior relationship, the bank's initial suggestion of the loan, failure by the officer to disclose a known fact, and reliance by the lender, all comport with the Texas courts' definition of a fiduciary relationship.

The evidence presented by the Energy Programs at trial was insufficient to support a finding under Texas law, or for that matter Indiana law, of a fiduciary relationship. The Energy Programs do not contest the fact that BancTexas had no prior relationship with the Energy Programs, let alone a relationship of the type which, at common law, might give rise to a fiduciary obligation. As to three of the Energy Programs for which the jury found a fiduciary relationship, BancTexas was not even a lender.[6] Assuming that a prior relationship was not necessary, there was insufficient

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6. Energy Programs 1981-7, 1981-8, and 1981-9.

evidence of facts removing their dealings from the sphere of an arms length debtor-creditor relationship. The evidence at trial could support a jury finding that Terry Smith [sic] vouched for Wells-Battelstein's credit. There was no evidence, however, that BancTexas or Terry Smith [sic] recommended the investment. Even the offering memorandum for each of the Energy Programs provided that:

> The Bank will not investigate or be responsible for . . . any of the activities of the Partnership . . . The Bank will act only as an arm's length lender.

The Court concludes that, on the evidence presented at trial, the jury could not have reasonably concluded that a fiduciary relationship existed between BancTexas and the Energy Programs as defined by Texas law.

The Court shall refrain from addressing BancTexas' alternative grounds for judgment n.o.v. having found the two previously addressed points dispositive.

Prejudgment Interest

As part of its motion for judgment, the Energy Programs seek prejudgment interest. The Court's ruling on BancTexas' motion renders the Energy Programs' request moot. Accordingly, the Court shall not state an opinion concerning the parties' arguments on this issue.

BancTexas' Motion for a Finding

BancTexas requests that the Court make a negative finding pursuant to Fed. R. Civ. P. 49(a) concerning the Energy Programs' negligent misrepresentation claim. The question they submit is as follows:

> Do you find from a preponderance of the evidence that in making the untrue statements, BancTexas was manifestly aware of the use to which the information was to be put and intended it for that purpose?

Having found that the Energy Programs failed to adduce proper evidence to support a jury finding on damages for negligent misrepresentation, the Court need not address

BancTexas' alternative grounds for judgment n.o.v. Accordingly, the Court shall refrain from making an additional finding.

Motion for New Trial

In the alternative to its motion for a judgment n.o.v., BancTexas request that the Court grant a new trial. Having granted BancTexas' motion for a judgment n.o.v. the Court must conditionally rule upon the motion for a new trial. Fed. R. Civ. P. 50(c)(1). The Court does not find any grounds for granting a new trial. See Fed. R. Civ. P. 59(a).

Conclusion

BancTexas' motion for judgment notwithstanding the verdict is hereby granted. In the event that this judgment is vacated or reversed, BancTexas' motion for a new trial is denied. The Energy Programs' motion for judgment is denied.

It is so **ORDERED**.

Dated this 6 day of August, 1984.

/s/ Robert M. Hill
United States Circuit Judge
Sitting by Designation

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	M.D.L. NO. 560
	§	
LETTERMAN BROTHERS	§	CA-3-82-1032-D
ENERGY PROGRAM	§	CA-3-83-1051-D
SECURITIES LITIGATION	§	CA-3-83-2098-D
	§	CA-3-83-2098-D

Dallas, Texas
March 29, 1984
9:00 a.m.

EXCERPT OF THE TRANSCRIPT OF THE TRIAL
BEFORE THE HONORABLE ROBERT M. HILL and a jury
(page 2048, lines 4 through 24)

THE COURT: No; we don't have any evidence of that. Now they may have mismanaged the property. They may have spent too much money. I don't know whether they did or they didn't. There is no proof. They spent X amount of dollars, but we don't know whether that's reasonable or unreasonable. We have no way of knowing. It might have taken every dime they spent to develop these properties. It was just a bad deal. They couldn't be developed.

But that's the kind of evidence that you need, somebody to come in here as an expert and give us an opinion. I don't think there is any evidence on the measure of damages. That's just one of the problems that we have on the 10b-5 claim.

I am not excluding the other issues, but that is the big issue that we don't have any evidence on. I have to grant their Motion on 10b-5.

MR. COUSINS: Thank you, Your Honor.

THE COURT: You don't have to thank me. I told you that yesterday. Maybe you weren't here. Were you here when I told Mr. Wineberg that he didn't have to thank me for anything? I'm being paid for just like the jury.

Now that also applies, Mr. Sayles, on the 10b-5.

THE COURT: What evidence do we have, then, as to the value as represented and the value had the representations not been made?

MR. WINEBERG: There is evidence in the record. They have the evidence of what was paid, what was paid on each of the programs. We also have the evidence in the record in which a juror can find from substantial evidence that these were worthless properties that they purchased. These properties were the sort where you were buying not only an interest; you were buying liability. You entered into an agreement in which you had to pay certain expenses.

THE COURT: What evidence do we have that on the date they acquired their investment and made their investments with Wells-Battelstein that those properties were valueless?

MR. WINEBERG: What we had -- We weren't buying the properties, Your Honor. We were buying an oil and gas -- a fraction of an oil and gas drilling lease that was going to be developed.

THE COURT: Now what evidence do we have as of that date that they were valueless, that they have had no value? What evidence do we have of a their value and the misrepresentations, alleged misrepresentations?

MR. WINEBERG: What you have to do, Your Honor -- And as the Court said in Falstaff Brewing Company, you have to use the best evidence you have in order to determine what that value was, and the best evidence --

THE COURT: Now that's an anti-trust suit?

MR. WINEBERG: I believe it was, Your Honor. It also applies in securities cases.

THE COURT: Well, now Huddleston applies to securities.

MR. WINEBERG: But the question is the general principal, Your Honor, what the amount, exact anticipated amount, of the damages is difficult.

THE COURT: Why is it difficult?

MR. WINEBERG: Because they were worthless, Your Honor. You can't --

THE COURT: Who said they were worthless?

MR. WINEBERG: The facts prove they were worthless. They were bought and sold because of misrepresentations and omissions.

THE COURT: Well, now how do we know that they were worthless?

MR. WINEBERG: Because as the evidence shows, as soon as the price of the package was established, they were losers, and it resulted in liability to the partnership.

THE COURT: How do we have they were losing? We have to look at subsequent events and transactions.

MR. WINEBERG: You have to do that in order to prove they were worthless at the time.

THE COURT: What did we look at to prove they were worthless?

MR. WINEBERG: You look at the amount paid, you look at the expenses that were charged, you look at the cash flow, you look at the liability that is assumed for operating expenses, and you find out that -- as Mr. Letterman testified -- they are incurring liabilities because the costs are exceeding the income, and the purchaser is constantly losing money because of the liability.

THE COURT: Well, it's just a bad investment. That's what you are saying is that it was a bad investment.

MR. WINEBERG: It was a bad investment, but you can't get out of the fact that it was a fraudulent investment. You can't forget the fact that there were misrepresentations.

THE COURT: All right. Now what value did the property have on the date it was acquired?

MR. WINEBERG: I submit --

THE COURT: What real value can it have?

MR. WINEBERG: I submit it had none, Your Honor, and the record is clear that at the price -- in the context of these securities that was sold, you have property that has to be developed. There has been testimony that these can be economical, and Mr. Terry Stewart testified to it, and Mr. MacFarlane testified to it, and they both said it on the stand.

If you have a very small operation where you can drill the well for five thousand dollars and have a local person go out and keep you on your low operating expenses, these leases at one or two barrels a day have value. We asked them at the stand if they had any value, other than that type of operation with a turnkey drilling price of twenty-five thousand dollars a well, and with a big company with per well charges, a Wells-Battelstein, was charging operating expenses,

and Mr. MacFarlane testified, no. In that case he said it depended on the operating costs.

Mr. Stewart talked about them being marginal properties at best. We have evidence that there was a ten thousand dollar profit built into the security on the turnkey drilling that the bank knew about in advance. There was also a profit built into the drilling company which was affiliated with Wells-Battelstein that was built into it.

THE COURT: What are the properties worth today?

MR. WINEBERG: I would like to get them off our back, Your Honor, because they are costing us money. We are incurring -- The Trustee claims that we owe them money.

THE COURT: What evidence do we have as to the value of those properties?

MR. WINEBERG: Scott testified that there were valueless. Mr. Letterman got up and testified that there were valueless, and

that the Trustee was billing them, and they had a negative liability, that they had to pay forty-five thousand dollars for last year.

THE COURT: What would be the value on equipment on the leases?

MR. WINEBERG: Negligible, Your Honor.

THE COURT: How do we know that? What effect did the price of oil have on this operation? What effect do you think the price of oil going down had on this operation?

MR. WINEBERG: I don't think it had any. It couldn't have made it, even at thirty-five dollars or thirty-eight dollars a barrel. We would have the exact same result at that price. If oil had gone to fifty or sixty dollars, yes.

We have a situation -- I did submit and was ruled on, and they were not admitted. I submitted the bills that the Trustee has submitted for operating expenses, which admittedly we contest. They show over a million dollars in expenses that the Trustee

has submitted to us, which are bills that the Trustee has submitted to Letterman Brothers on these programs.

THE COURT: Do you want to make any comment? Let me ask you, Mr. Kroemer. You are directly involved in this too. Do you want to make any comment in addition?

MR. KROEMER: It seems to me, Judge, that it's clear from the entire testifimony of the trial that but for the misrepresentations by Wells-Battelstein that the properties would have had no value, because they couldn't have sold them without those misrepresentations.

THE COURT: What value did they have?

MR. KROEMER: In the hands of Wells-Battelstein, I think, based on the testimony, in the hands of Wells-Battelstein they didn't have any value, because Wells-Battelstein could not do what they have represented they can do. All they could do is drill holes and create liabilities, and so I think in the

hands of Wells-Battelstein these properties did not have any economic value, and the subsequent events have proven that, Judge.

And so I agree with Mr. Wineberg. I think the jury can look at that and reach a reasonable determination. I don't think it requires an expert to come in here and tell us in his opinion, as to these misrepresentations, that these properties could have done X, because you would have to look at the way it was.

THE COURT: Well, can't an expert look at an oil and gas property and give us an opinion as to the value that properties on a given date?

MR. WINEBERG: I think we have learned in this case that's very chancy, Your Honor. It depends upon operating expenses, and it depends on a lot of things.

There is one other test I would like to mention to Your Honor, which is something that is directly in the record, and that is that

Mr. Letterman was asked the question in the examination how much would he have paid for these properties if he had had a full disclosure, but for the disclosures that were made to him, if he had known, if they had told him that there were doing a ten thousand dollar profit on turnkey drilling, if they had told him this the operating expenses would run sixty-five to a hundred percent on the property, and his answer was, "I wouldn't have paid a penny."

And that's the context that you will also have to consider as to what the damages were. It's the whole package that must be considered on the investment, Your Honor, rather than just the lease.

THE COURT: Well, reading from Huddleston, the court says neither the application or the out of pocket measure too complex to be applied in this case. The use of the out of pocket rule will require that a true or real value, i.e., the value the

securities would have had absent the misrepresentations, be established for each date on which members of the class purchased during the ninety day class period.

"Once those values are obtained, possibly with the help of exert witnesses or a special master, then the determination of each individual plaintiff's recovery becomes a simple matter of subtraction of the true value of the security on the date of the plaintiff's purchase from the purchase price paid by the plaintiff on that date.

"The Issue of damages is thus an individual matter to be determined separately from each member of the plaintiff class."

Now in this case we don't have -- Well, in a sense we do have a class. We have a class of programs, and each program would have to establish the true value of that property on the date it acquired the property. There just isn't any evidence, none. It doesn't exist in this case.

MR. WINEBERG: Your Honor, I would submit the language as to the misrepresentation would be the value. Do we have evidence that absent of the misrepresentation there would be no value?

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of January 1987, three copies of the Petition For Writ Of Certiorari were mailed, postage prepaid, to W. Ted Minick, Esq., Winstead, McGuire, Sechrest & Minick, 1700 Mercantile Dallas Building, Dallas, Texas 75201, counsel for the Respondent; J. Albert Kroemer, Esq., Matthews and Kroemer, One Main Place, Suite 2000, Dallas, Texas 75202-3977; Richard A. Sayles, Esq., Carrington, Coleman, Sloman & Blumenthal, 110 East Davis Street, McKinney, Texas 75069. I further certify that all parties required to be served have been served.

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86 - 1154

Supreme Court, U.S.
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In The

Supreme Court of the United States

OCTOBER TERM, 1986

LETTERMAN BROTHERS ENERGY PROGRAMS 1980-2, et. al.,

Petitioners,

v.

BANCTEXAS DALLAS, N.A.,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

Whether a plaintiff who relied on the out-of-pocket measure of damages in the trial court but failed to introduce any evidence from which damages could be determined under that measure should be allowed to recover under the recission measure of damages.

PARTIES TO THE PROCEEDING

PETITIONERS:

Letterman Brothers Energy Program 1980-2, a California limited partnership.

Letterman Brothers Energy Program 1980-5, a California limited partnership.

Letterman Brothers Energy Program 1980-6, a California limited partnership.

Letterman Brothers Energy Program 1980-10, a California limited partnership.

Letterman Brothers Energy Program 1981-1, a California limited partnership.

Letterman Brothers Energy Program 1981-3, a California limited partnership.

Letterman Brothers Energy Program 1981-5, a California limited partnership.

Letterman Brothers Energy Program 1981-6, a California limited partnership.

Letterman Brothers Energy Program 1981-7, a California limited partnership.

Letterman Brothers Energy Program 1981-8, a California limited partnership.

Letterman Brothers Energy Program 1981-9, a California limited partnership.

RESPONDENT:

BancTexas Dallas, N.A., formerly known as National Bank of Commerce of Dallas, Texas, a National Banking Association

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STATURY PROVISIONS INVOLVED

BancTexas disagrees that the statutory provisions set forth by Petitioners are involved in this Petition. The only statutory provision involved is the portion of section 28(a) of the Securities Exchange Act of 1934 which deals with damages as follows:

> [N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

15 U.S.C. §78bb(a).

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BANCTEXAS DALLAS, N.A.,

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BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

STATEMENT OF THE CASE

Much of Petitioners' Statement of the Case is pure argument unrelated to the issue of law presented. Moreover, Petitioners misstate and mischaracterize the evidence in a blatant attempt to bias the Court.

The sole question presented by Petitioners involves the applicable meaure of damages under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Contrary to the implications of Petitioners, there has been no finding of fraud under such act. Rather, at the

conclusion of the Petitioners' evidence, the trial court granted BancTexas' Motion for Directed Verdict because Petitioners had failed to prove damages. Significantly, at trial, Petitioners did not seek the application of any measure of damages other than the "out-of-pocket" measure. In fact, Petitioners argued that their proof qualified under that measure.[1]

Petitioners seek to make it appear that the Letterman Brothers, who syndicated the eleven petitioning partnerships, were inexperienced in oil and gas and relied entirely upon BancTexas. This is inaccurate. Bryce and Scott Letterman were stockbrokers who commenced oil and gas activities in 1978. They thoroughly checked out the operators of their oil and gas programs prior to deciding to use them.

Before BancTexas had ever heard of Letterman Brothers, Bryce Letterman had met with Barry Battelstein; had visited Wells-Battelstein's offices in Houston; had met all their key people; had visited Wells-Battelstein's offices, machine shops, truck yards, leases in Kansas; had talked to Wells-Battelstein's suppliers, contractors, and geologists, had requested and received a financial statement; and had requested and received a drilling history.

Letterman had contacted the Bank in Ohio that had financed some of his prior programs about financing investments with Wells-Battelstein and was told that they would not finance these programs. He then went to BancTexas. On May 1, 1980, Letterman met with Terry Stuart of BancTexas. Bryce Letterman testified that Stuart told him (1) Wells-Battelstein was one of the Bank's most successful customers, (2) he thought Wells-Battelstein was

[1] Only post trial have Petitioners sought application of some other measure. In summary, Petitioners are not asking this Court to correct or modify the application of law, but to correct Petitioners' failure of proof.

a very high integrity company, (3) the bank thought a lot of them as a customer, and (4) they were very creditworthy. Stuart also told him Wells-Battelstein had a $1,000,000 line of credit that would soon be increased to $2,500,000. These statements form the basis of Petitioners' claims that BancTexas defrauded the partnerships (formed over the next eighteen months) to invest in the Kansas mineral leases.

Before entering into any of the ventures, Letterman hired independent petroleum geologists to review the geological information provided by Wells-Battelstein. This geologist was retained by each partnership to determine whether it should invest in the prospect. Letterman had attorneys investigate Wells-Battelstein to insure that the information contained in the offering circular, which would be presented to the State of California and to potential investors, was accurate.

In their attempt to gloss over their failure of proof, Petitioners ignore many relevant facts in their arguments that the oil and gas leases purchased by them were worthless. Petitioners ignore the fact that actual reserves were far less than hoped for. Petitioners ignore the fact that oil and gas prices, rather than going up to the anticipated $60.00 per barrel, went down. Petitioners also characterize their position as being "locked into contractual liabilities under the operating agreements" when, in fact, Petitioners had the right and ability to remove Wells-Battelstein as the operator on the leases. Most importantly, Petitioners ignore the fact that some of the programs actually generated profits.

The truly relevant facts in this case can be briefly summarized. Letterman Brothers became interested in form-

ing oil and gas development partnerships involving Wells-Battelstein. Wells-Battelstein was a customer of BancTexas. Bryce Letterman came to BancTexas seeking loans to enable him to put together the programs he desired to promote and sell after other banks had decided not to finance these programs. Letterman Brothers were paid substantial fees by the programs. All these programs were very highly leveraged. Interest rates went up considerably, very little oil and gas was found, and oil prices dropped. As a result, Petitioners were unable to pay their debt to BancTexas. The investors looked to Letterman Brothers and several suits were filed against them. Wells-Battelstein went bankrupt. By agreeing to waive the statute of limitations, Letterman Brothers were able to get the investors to halt prosecution of their suits while they pursued this suit on behalf of all investors against BancTexas. Only then did the Energy Programs institute suit against BancTexas.

BancTexas asserted numerous grounds in support of its Motion for Directed Verdict on the 10b-5 claim. As stated by the District Court, the measure of damages was "just one of the problems that we have on the 10b-5 claim." A-10 Appendix. However, the District Court did not reach the other issues after concluding that there was no evidence on the proper measure of damages. Before this Court, Petitioners omit the first two pages of the Transcript concerning the measure of damages in which Petitioners' counsel agreed that the out-of-pocket measure is appropriate. Petitioners also took the liberty of presenting the end of the argument as the first two pages in their Appendix D. A corrected excerpt of the Transcript beginning on page 2038 in the order that it actually occurred is included as Appendix A.

REASONS FOR DENYING THE WRIT

1. THERE ARE NO SPECIAL OR IMPORTANT REASONS CALLING FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

Certiorari lies only where there are special and important reasons. Sup. Ct. R. 17.1, 28 U.S.C. There are none in this case. There is no conflict between decisions of the courts of appeals on the proper measure of damages applicable to this case. The Fifth Circuit has not so far departed from the accepted and usual course of judicial proceedings or sanctioned such a departure by the district court. The Fifth Circuit did not decide an important question of federal law which has not been, but should be, settled by this Court. Finally, the Fifth Circuit did not decide a federal question in a way in conflict with applicable decisions of this Court. *Id.*

2. PETITIONERS COULD HAVE PRESENTED EVIDENCE ON DAMAGES UNDER THE OUT-OF-POCKET MEASURE BUT FAILED TO DO SO.

Petitioners elected to rely upon the out-of-pocket measure of damages in the district court.[2] However, Petitioners failed to present evidence of the fair market value of the alleged securities on any relevant date.[3] This is true whether the traditional out-of-pocket measure is used or

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[2] Appendix A-1. Mr. Wineberg: "Yes, Your Honor; and what we were submitting is not an argument over the fact that we have the out of pocket damages as being our test."

[3] District Court Opinion, Petitioner's Appendix B-15.

the modified out-of-pocket measure as applied in *Chasins v. Smith Barney & Co., Inc.*, 438 F.2d 1167 (2d Cir. 1970) is used.[4] Petitioners had an adequate opportunity to present evidence at trial on the proper measure of damages. District Court Opinion, Petitioner's Appendix B-16. Petitioner's failure to present evidence on the proper measure of damages did not result from a technical error or any conduct of BancTexas but rather from Petitioners' own decision. *Id.* Finding themselves precluded from recovery because of their failure to prevent evidence on damages, Petitioners now seek to get this Court to sanction utilization of the rescission measure of damages in the case at bar if not all cases. The thrust of Petitioners' argument is that the "securities laws . . . must be construed flexibly to effectuate their remedial purposes . . . and the courts must adjust the remedies so as to grant the necessary relief where federally secured rights are invaded."[5] This invitation should be declined. The fact that a party is pursuing a cause of action which has been generally recognized to serve the public interest provides no basis for concluding that it is relieved of showing the usual prerequisites to recovery. *Rondea v. Mosinee Paper Corp.*, 422 U.S. 49, 64-65 (1975).

Relying on this Court's recent statement that "[t]he issue whether and under what circumstances . . . a rescissionary measure of damages is available under §10(b) is an unsettled one," Petitioners argue that this case presents an excellent opportunity to address that issue. *See Randall*

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[4] *See Id.* and discussion of *Chasins, infra.*

[5] Petition at 14. It should be noted that there are serious questions as to both whether any federally secured rights were involved or invaded.

v. Loftsgaarden, 478 U.S. ....., 106 S.Ct. 3143, 3152 (1986)). There is nothing unusual about this case which warrants a deviation from the generally accepted out-of-pocket measure which was recognized in *Randall v. Loftsgaarden. Id.* at 3153.

Petitioners inaccuratley argue that utilization of the out-of-pocket measure of damages leaves them with no remedy. BancTexas' Motion for Directed Verdict was granted because Petitioners merely failed to introduce any evidence from which such damages could be determined. This was either an oversight or a consciuos decision on Petitioners' part. It does not call for an expansion or liberalization of the appropriate measure of damages to be applied in Rule 10b-5 cases.

The Fifth Circuit, recognizing that a rescissional measure of damages is applicable in some cases, properly held that BancTexas was not within the category of parties against whom rescissional damages may be awarded. *In re Letterman Brothers Energy Securities Litigation,* 799 F.2d 967, 972 (5th Cir. 1986). As recognized by the Fifth Circuit, to hold BancTexas liable under a rescissional measure of damages would place on it the entire burden of any decline in value of the security even though only a portion of the decline may have been caused by the conduct complained of. *Id.* at 972-73.

Petitioners misquote the Fifth Circuit by saying that the decision below recognized that the evil was the inducement, not the price. In stating that Petitioners might have pursued a claim for consequential damages, but failed to present such evidence, the Fifth Circuit actually said that

"any misrepresentation BancTexas might have made went not to the value of the leases and equipment acquired but to the decision to choose Wells-Battelstein as the operator." *Id.* at 973 n. 5. Thus, the Court was not saying that BancTexas induced the investments. It should also be noted that Petitioners could have replaced Wells-Battelstein as the operator. However, they would have suffered the same fate because the leases simply proved to have inadequate reserves to be profitable in a period of high interest rates with low oil prices.[6]

Petitioners' argument that if what they received must be valued at the date of the contract then it must be concluded that they received exactly what they paid for and thus suffered no damages under the out-of-pocket measure is simply wrong. Petitioners were not precluded from recovering because no damages *could* be shown under the out-of-pocket measure but rather because Petitioners failed to present any evidence thereon. Petitioners did receive tangible property and rights which had value. Petitioners merely failed to present evidence of the value of what they received absent Wells-Battelstein as the operator and choose to seek recovery of all their losses including those caused by the economy and mother nature. Petitioners cite no authority which would sanction such a result but rather ask this Court to create such authority and allow all 10b-5 claimants to elect this measure of damages.

Petitioners cite Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Dam-*

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[6] Mr. Wineberg himself argued that the leases would have been profitable had oil prices gone up to the projected $60 per barrel price. Appendix A-7.

ages, 37 Vand. L. Rev. 349, 351 (1984) as authority that "recent decisions evidence a trend toward the use of the rescissionary measure." Pet. at. 15. Professor Thompson actually said

> Recent decisions in securities cases evidence a trend toward a result that combines elements of both out of pocket and rescission theories. Courts increasingly are awarding . . . the difference between the value of what [plaintiff] gave up . . . and the value of what [plaintiff] received, measured at a reasonable time after discovery of the fraud.

Id. This is actually the modified out-of-pocket measure of damages and Petitioners failed to offer any evidence on the value of what they received "at any relevant date." District Court Opinion, Petitioners' Appendix B-15.

Professor Thompson's article on the Measure of Recovery under Rule 10b-5 actually deals mostly with the difference between tort theories of recovery, out-of-pocket, and unjust enrichment theories. Unjust enrichment in securities law is often called disgorgement. However, reviewing the article and trying to apply each of the measures discussed illuminates the fact that Petitioners cannot recover under any measure but rescission because there is no evidence from which damages can be calculated. Petitioners cannot recover under the out-of-pocket measure or the modified out-of-pocket measure because there is no evidence of the value of the interests purchased on any relevant date. Petitioners cannot recover under an unjust enrichment or disgorgement measure because there is no evidence of any profits to BancTexas. In fact, BancTexas lost millions of dollars.

3. THERE IS NO CONFLICT AMONG THE CIRCUITS

Petitioners argue that any time the alleged misrepresentation goes to the decision to invest rather than the price, the rescissional measure of damages should be applicable. Petitioners urge this Court to extend the applicability of the rescissional measure to all cases.

There is no conflict between the decision below and the cases relied upon by Petitioners. The Fifth Circuit expressly recognized that the rescission measure could be applied where there is privity or where the defendant owes some fiduciary duty such as that owed by a broker to his customer.[7] *In re Letterman Bros.*, 799 F.2d 967, 972 (5th Cir. 1986). These conditions exist in the cases relied upon by Petitioners. Further, the cases relied upon by Petitioners do not apply the rescission measure but rather apply the modified out-of-pocket measure.

Petitioners rely principally upon *Chasins v. Smith Barney & Co.,, Inc.*, 438 F.2d 1167 (2d Cir. 1970) where the defendant was a broker. *Chasins* did not apply a rescission measure of damages as advocated by Petitioners but rather used the modified out-of-pocket measure. Under the *Chasins* measure, a buyer recovers the fair value of the consideration paid less the fair value of the security *within a reasonable time* after the buyer discovered or should have discovered the fraud. In *Chasins,* value was determined by the price received when the Plaintiff sold the securities before learning of the manipulative conduct.

[7] Petitioners attempt to confuse the issue by questioning when a bank might be acting in a situation closely analogous to that of a broker. In fact, the district court held that there was no fiduciary relationship between Petitioners and BancTexas and this was affirmed by the Fifth Circuit. *In re Letterman Bros.*, 799 F.2d at 975.

Id. at 1173. Petitioners, however, have failed to provide sufficient evidence of fair market value *on any relevant date.* District Court Opinion, Petitioners Appendix B-15.

Garnatz v. Stifel, Nicolaus & Co., Inc., 559 F.2d 1357 (8th Cir. 1977), *cert. denied,* 435 U.S. 951 (1978) also does not conflict with the decision in the case at bar. The defendant in *Garnatz* was a broker. The Fifth Circuit expressly recognized that the rescission measure could be applied in such a case. Like *Chasins,* the Court in *Garnatz* also recognized that the plaintiff must bear any decline in value after actual or constructive knowledge of the alleged conduct and applied the modified out-of-pocket measure. *Garnatz,* 559 F.2d at 1361. There also was evidence of such value, which is absent in the case at bar.

In *Esplin v. Hirschi,* 402 F.2d 94, 104 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969) there was privity and the court awarded recovery under the modified out-of-pocket measure. There was evidence and a jury finding of this value. *Id.*

Contrary to the Petitioners' position that only the Fifth Circuit requires privity or a fiduciary relationship before applying the rescissional measure of damages, "[e]very case awarding defrauded buyers a rescission measure of damages displays a distinctive element . . . [they] are accented either by privity or by the special duty owed by brokers to their customers." Note, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities,* 26 Stan. L. Rev. 371, 376-77 (1974). Nor are these requirements irrational and inappropriate as suggested by Petitioners. If the relationship limits are broadly expanded as requested by Petitioners, rescissionary dam-

ages "should be deemed inappropriate" unless "a workable means of distinguishing risks and losses is developed and applied. . . ." *Id.* at 377. Petitioners wholly failed to provide any evidence to distinguish the risks and losses hoping to recover every dollar invested even though much, if not all, of their losses were due to economic and natural forces which risks they assumed. Further, the equitable principals underlying utilization of the rescission or unjust enrichment measures should not be applied where the defendant was not unjustly enriched nor more culpable than merely negligent. *Id.* at 385. While Petitioners try mightily to make the Court feel that BancTexas is guilty of fraudulent conduct, that issue never reached the jury.

There are patent difficulties inherent in the application of the rescissional measure to transactions between purchasers and parties who were not sellers. *Huddleston v. Herman & MacLean,* 640 F.2d 534, 554 (5th Cir. 1981), *aff'd in part and rev'd and remanded on other grounds,* 459 U.S. 375, *on remand,* 705 F.2d 775 (5th Cir. 1983). Even under §12 of the 1933 Act, 15 U.S.C. §771, which expressly provides a rescissional measure of damages, such recovery is limited to situations where the plaintiff purchased from the defendant. *See Id.* A defendant who was not the seller is unable to return the price paid because he did not receive it and cannot rescind a transaction to which he was not a party. *Huddletson, supra* at 555. More importantly, application of a rescissional measure in such a case places upon the defendant the burden of any decline in value including those resulting from factors unrelated to the alleged wrong. *Id.* Under these circumstances, a rescissional measure is unjust because it compensates a plaintiff for the

risks which he assumed by entering the market. *Id.* These losses bear no relationship to the benefits derived by the defendant nor to the blameworthiness of the alleged conduct. *Id.*

Petitioners ask this Court to adopt a theory expressly rejected by *Huddleston* that "but for" the alleged actions of BancTexas they would not have purchased and hence would have suffered no losses. *Id.* In this case, the proper measure of damages to reflect the loss proximately caused by the alleged misconduct of BancTexas is the out-of-pocket measure. This would merely require valuing the assets and rights purchased with an operator other than Wells-Battelstein. If this in fact is zero as Petitioners state, then Petitioners have established that their losses are due to economic changes and the fact that the oil reserves proved to be less than hoped for, all of which are risks inherent in speculating in the oil and gas business.

Petitioners cite *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath,* 378 F. Supp. 112, 129 (S.D.N.Y. 1974), *modified,* 540 F.2d 27 (2d Cir. 1976) for the proposition that the securities can be valued as of the time of trial. The Court in *Herzfeld* did not make such a holding. Rather, the court, on its own motion, reduced the damages by the value of the securities. *Id.* Defendant had attacked only the award of interest and thus no issue was presented or discussed as to the proper date on which value should be fixed. In this same discussion, Petitioners twist the decision in the case at bar by saying that the Fifth Circuit has precluded them from recovering because there is no privity or fiduciary duty. Petitioners' inability to recover results

from their own failure to introduce sufficient evidence of the value of the assets and rights received as of any relevant date.

Harris v. American Investment Co., 523 F.2d 220, 226 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976) is a summary judgment case and does not address the issue of when the recissionary measure of damages is applicable. In fact, *Harris* merely discusses dates that *might* be used for determining value under the out-of-pocket measure and concludes that it *may* be proper to determine value as of the date the public discovers the fraud because only then would the market price of the stock reflect the true value absent the misrepresentations. *Id.* at 226. This is merely looking at the market price of a stock on a subsequent date as evidence of its true value on the date the plaintiff purchased.

Acceptance of Petitioners' arguments would extend the rescissional measure of damages to all cases. It is difficult to imagine a case when a Plaintiff could not argue that but for the fraudulent conduct he would not have purchased. Such an expansion is unwarranted.

CONCLUSION

The Securities Exchange Act of 1934 provides that "no person . . . shall recover . . . a total amount in excess of his actual damages *on account of the act complained of.*" 15 U.S.C. §78bb(a) (emphasis added). Petitioners ask this Court to ignore this requirement of causation and establish a standard which will allow recovery from a non seller of all amounts spent. Petitioners ask this Court to estab-

lish this liberal standard so that they may avoid the effect of their own failure to offer evidence on the value of the property purchased by them as of any relevant date so that damages could be determined under the out-of-pocket measure upon which they relied. There are no special or important reasons calling for review on writ of certiorari.

Respectfully submitted,

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Dated: February 11, 1987

CERTIFICATE OF SERVICE

I hereby certify that on this ..... day of February, 1987, three copies of the Brief in Opposition to Petition for Writ of Certiorari were mailed, postage prepaid, to William A. Wineberg, Broad, Schulz, Larson & Wineberg, One California Street, 14th Floor, San Francisco, California 94111, counsel for Petitioners; J. Albert Kroemer, Esq., Matthews and Kroemer, One Main Place, Suite 2000, Dallas, Texas 75202-3977; Richard A. Sayles, Esq., Carrington, Coleman, Sloman & Blumenthal, 110 East Davis Street, McKinney, Texas 75069. I further certify that all parties required to be served have been served.

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In The
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
Dallas Division

In Re:	(	M.D.L. No. 560
	(	
LETTERMAN BROTHERS	(	CA3-82-1032-D
ENERGY PROGRAM	(	CA3-83-1051-D
SECURITIES LITIGATION	(	CA3-83-2098-D

Dallas, Texas
March 29, 1984
9:00 a.m.

Excerpt of the Transcript of the Trial
Before The Honorable Robert M. Hill and a Jury
(page 2038 line 5 through page 2048 line 18)

THE COURT: Okay. Mr. Wineberg, I think the thing we need to address first is the measure of damages. That has been raised as a most serious ground, I would assume, and that would apply to your 10b-5 claims or your Act claims, and also it would probably apply to the Texas Security Act, because it's a mirror image of the 12 b, Section 12 b, rulings, the 10b-5.

He has got this — I assume you read the Huddleston case. The Fifth Circuit says — The Huddleston case says that the measure of damages in a 10b-5 case is the, quote, out of pocket measure, end quote, and that't the difference between the price paid and the real value of the security. In other words, the fair market value and the misrepresentations and the critical language, I guess, is, quote, at the time of the initial purchase by the defrauded buyer, end quote.

MR. WINEBERG: Yes, Your Honor; and what we

were submitting is not an argument over the fact that we have out the pocket damages as being our test.

THE COURT: Does your evidence —

MR. WINEBERG: The question is how we measure it, as was recognized by the Court in the Austin Lovegar decision, which is Eighth Circuit. But one of the leading cases in this area says the measure is not a talisman but a function of the court to fashion the remedy best suited to the harm. You have to look at what type of securities are being purchased.

THE COURT: Well, these are oil and gas.

MR. WINEBERG: These are oil and gas interests, which is very different than if you were buying General Motor stock on the New York Stock Exchange.

THE COURT: Let me stop you right there. The Fifth Circuit in Huddleston footnotes cites some cases that support their definition of out of pocket expenses, and one of those cases, the North Texas — North, dash, Texas — Agency versus Jones, which is an oil and gas undivided interest purchase in an oil and gas investment.

I know about the case. I tried it ten years ago.

MR. WINEBERG: I didn't get a chance to read it last night, Your Honor.

THE COURT: Well, it's an oil and gas case where plaintiff purchased an undivided interest in some oil and gas prospects, and the measure of damages in the case was that expressed in the Huddleston case, and they have cited that as the support of that statement.

In addition, in this last case — there is Judge Higgen-

botham's case in 1984, February 27 — Siebel, S-i-e-b-e-l, versus Scott, and he reaffirms that where he says where all of the elements of a Section b violation are proven, quote, the proper measure of damages to reflect the loss proximately caused by the defendants' defeat is the out of pocket rule.

That rule is the traditional measure of damages in a Rule 10b-5 action, and got the — He was quoting Huddleston, and then he goes on to say, "It is the out of pocket rule allows damages, quote, the difference between the price received on the value of the securities at the time of the fraudulent transaction, end quote, citing Alley, A-l-l-e-y, versus Miramom, M-i-r-a-m-o-m, another Fifth Circuit case, 1980.

So, it's pretty well established in this Circuit — I'm not saying what the Eighth Circuit would do, but in this Circuit this is the test.

MR. WINEBERG: And we feel and would be happy to go to the jury on that question based on the truth that we have.

THE COURT: What evidence do we have, then, as to the value as represented and the value had the representations not been made?

MR. WINEBERG: There is evidence in the record. They have the evidence of what was paid, what was paid on each of the programs. We also have the evidence in the record in which a juror can find from substantial evidence that these were worthless properties that they purchased. These properties were the sort where you were buying not only an interest; you were buying liability. You entered into an agreement in which you had to pay certain expenses.

THE COURT: What evidence do we have that on the date they acquired their investments and made their investments with Wells-Battelstein that those properties were valueless?

MR. WINEBERG: What we had — We weren't buying the properties, Your Honor. We were buying an oil and gas — a fraction of an oil and gas drilling lease that was going to be developed.

THE COURT: Now what evidence do we have that as of that date that they were valueless, that they have had no value? What evidence do we have of a their value and the misrepresentations, alleged misrepresentations.

MR. WINEBERG: What you have to do, Your Honor — And as the Court said in Falstaff Brewing Company, you have to use the best evidence you have in order to determine what that value was, and the best evidence —

THE COURT: Now that's an anti-trust suit?

MR. WINEBERG: I believe it was, Your Honor. It also applies in securities cases.

THE COURT: Well, now Huddleston applies to securities.

MR. WINEBERG: But the question is the general principal, Your Honor, what the amount, exact anticipated amount, of the damages is difficult.

THE COURT: Why is it difficult?

MR. WINEBERG: Because they were worthless, Your Honor. You can's —

THE COURT: Who said they were worthless?

MR. WINEBERG: The facts prove they were worthless. They were bought and sold because of misrepresenta-

tions and omissions.

THE COURT: Well, now how do we know that they were worthless?

MR. WINEBERG: Because as the evidence shows, as soon as the price of the package was established, they were losers, and it resulted in liability to the partnership.

THE COURT: How do we have they were losing? We have to look at subsequent events and transactions.

MR. WINEBERG: You have to do that in order to prove they were worthless at the time.

THE COURT: What did we look at to prove they were worthless?

MR. WINEBERG: You look at the amount paid, you look at the expenses that were charged, you look at the cash flow, you look at the liability that is assumed for operating expenses, and you find out that — as Mr. Letterman testified — they are incurring liabilities because the costs are exceeding the income, and the purchaser is constantly losing money because of the liability.

THE COURT: Well, it's just a bad investment. That's what you are saying is that it was a bad inverstment.

MR. WINEBERG: It was a bad investment, but you can't get out of the fact that it was a fraudulent investment. You can't forget the fact that there were misrepresentations.

THE COURT: All right. Now what value did the property have on the date it was acquired?

MR. WINEBERG: I submit —

THE COURT: What real value can it have?

MR. WINEBERG: I submit it had none, Your Honor, and the record is clear that at the price — in the context of these securities that was sold, you have property that has to be developed. There has been testimony that these can be economical, and Mr. Terry Stewart testified to it, and Mr. MacFarlane testified to it, and they both said it on the stand.

If you have a very small operation where you can drill the well for five thousand dollars and have a local person go out and keep you on your low operating expenses, these leases at one or two barrels a day have value. We asked them at the stand if they had any value, other than that type of operation with a turnkey drilling price of twenty-five thousand dollars a well, and with a big company with per well charges, a Wells-Battelstein, was charging expenses, and Mr. MacFarlane testified, no. In that case he said it depended on the operating costs.

Mr. Stewart talked about them being marginal properties at best. We have evidence that there was a ten thousand dollar profit built into the security on the turnkey drilling that the bank knew about in advance. There was also a profit built into the drilling company which was affiliated with Wells-Battelstein that was built into it.

THE COURT: What are the properties worth today?

MR. WINEBERG: I would like to get them off our back, Your Honor, because they are costing us money. We are incurring — The Trustee claims that we owe them money.

THE COURT: What evidence do we have as to the value of those properties?

MR. WINEBERG: Scott testified that they were value-

less. Mr. Letterman got up and testified that they were valueless, and that the Trustee was billing them, and they had a negative liability, that they had to pay forty-five thousand dollars for last year.

THE COURT: What would be the value on equipment on the leases?

MR. WINEBERG: Negligible, Your Honor.

THE COURT: How do we know that? What effect did the price of oil have on this operation? What effect do you think the price of oil going down had on this operation?

MR. WINEBERG: I don't think it had any. It couldn't have made it, even at thirty-five dollars or thirty-eight dollars a barrel. We would have the exact same result at that price. If oil had gone to fifty or sixty dollars, yes.

We have a situation — I did submit and was ruled on, and they were not admitted. I submitted the bills that the Trustee has submitted for operating expenses, which admittedly we contest. They show over a million dollars in expenses that the Trustees has submitted to us, which are bills that the Trustee has submitted to Letterman Brothers on these programs.

THE COURT: Do you want to make any comment? Let me ask you, Mr. Kroemer. You are directly involved in this too. Do you want to make any comment in addition?

MR. KROEMER: It seems to me, Judge, that it's clear from the entire testimony of the trial that but for the misrepresentations by Wells-Battelstein that the properties would have had no value, because they couldn't have sold them without those misrepresentations.

THE COURT: What value did they have?

MR. KROEMER: In the hands of Wells-Battelstein, I think, based on the testimony, in the hands of Wells-Battelstein they didn't have any value, because Wells-Battelstein could not do what they have represented they can do. All they could do is drill holes and create liabilities, and so I think in the hands of Wells-Battelstein these properties did not have any economic value, and the subsequent events have proven that, Judge.

And so I agree with Mr. Wineberg. I think the jury can look at that and reach a reasonable determination. I don't think it requires an expert to come in here and tell us in his opinion, as to these misrepresentations, that those properties could have done X, because you would have to look at it the way it was.

THE COURT: Well, can't an expert look at an oil and gas property and give us an opinion as to the value that properties on a given date?

MR. WINEBERG: I think we have learned in this case that's very chancy, Your Honor. It depends upon operating expenses, and it depends upon a lot of things.

There is one other test I wold like to mention to Your Honor, which is something that is directly in the record, and that is that Mr. Letterman was asked the question in the examination how much would he have paid for these properties if he had had a full disclosure, but for the disclosures that were made to him, if he had known, if they had told him that there were doing a ten thousand dollar profit on turnkey drilling, if they had told him this the operating expenses would run sixty-five to a hundred percent on the property, and his answer was, "I wouldn't have paid a penny."

And that's the context that you will also have to consider as to what the damages were. It's the whole package that must be considered on the investment, Your Honor, rather than just the lease.

THE COURT: Well, reading from Huddleston, the court says neither the application or the out of pocket measure too complex to be applied in this case. The use of the out of pocket rule will require that a true or real value, i.e., the value the securities would have had absent the misrepresentations, be established for each date on which members of the class purchased during the ninety day class period.

"Once those values are obtained, possibly with the help of expert witnesses or a special master, then the determination of each individual plaintiff's recovery becomes a simple matter of subtraction of the true value of the security on the date of the plaintiff's purchase from the purchase price paid by the plaintiff on that date.

"The issue of damages is thus an individual matter to be determined separately from each member of the plaintiff class."

Now in this case we don't have — Well, in a sense we do have a class. We have a class of programs, and each program would have to establish the true value of that property on the date it acquired the property. There just isn't any evidence, none. It doesn't exist in this case.

MR. WINEBERG: Your Honor, I would submit the language as to the misrepresentation would be the value. Do we have evidence that absent of the misrepresentation there would be no value.

THE COURT: No; we don't have evidence of that.

Now they may have mismanaged the property. They may have spent too much money. I don't know whether they did or they didn't. There is no proof. They spent X amount of dollars, but we don't know whether that's reasonable or unreasonable. We have no way of knowing. It might have taken every dime they spent to develop these properties. It was just a bad deal. They couldn't be developed.

But that's the kind of evidence that you need, somebody to come in here as an expert and give us an opinion. I don't think there is any evidence on the measure of damages. That's just one of the problems that we have on the 10b-5 claim.

I am not excluding the other issues, but that is the big issue that we don't have any evidence on. I have to grant their Motion on 10b-5.